# Ex post evaluation of Macro-Financial Assistance to Bosnia and Herzegovina

## Final report

Client: European Commission, Directorate General for Economic and Financial Affairs

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# Abbreviations

| | |
|---|---|
| BAC | Business Enabling Environment Structural Adjustment Credit |
| BAM | Convertible Mark |
| BiH | Bosnia and Herzegovina |
| BoP | Balance of payments |
| CAFAO | Customs and Fiscal Assistance Office |
| CARDS | Community Assistance for Reconstruction, Development and Stabilisation |
| CBBH | Central Bank of Bosnia and Herzegovina |
| CPI | Consumer Price Index |
| CPIA | Country Policy and Institutional Index |
| DFID | Department for International Development (United Kingdom) |
| DG ECFIN | Directorate General for Economic and Financial Affairs |
| DPL | Development Policy Loan |
| EBPAC | Enterprise and Bank Privatisation Adjustment Credit |
| EBRD | European Bank for Reconstruction and Development |
| EC | European Commission |
| EIB | European Investment Bank |
| EMSAC | Economic Management Structural Adjustment Credit |
| EU | European Union |
| FBiH | Federation of Bosnia and Herzegovina |
| FDI | Foreign direct investment |
| FPA | Federal Privatisation Agency |
| GDP | Gross domestic product |
| GTZ | Deutsche Gesellschaft für Technische Zusammenarbeit |
| IAGP | International Assistance Group for Privatisation |
| IDA | International Development Association (World Bank, concessional) |
| IFI | International Financial Institution |
| IMF | International Monetary Fund |
| ITA | Indirect Tax Authority |
| KM | Convertible Marka |
| MFA | Macro-Financial Assistance (EC) |
| MoU | Memorandum of Understanding (EC) |
| NFC | National Fiscal Council |
| NPV | Net present value |
| OA | Operational Assessment |
| PFSAC | Public Finance Structural Adjustment Credit |
| PPA | Public Procurement Agency |
| PRB | Procurement Review Body |
| PTAC | Privatisation Technical Assistance Credit |
| RS | Republika Srpska |
| RSNA | Republika Srpska National Assembly |

| | |
|---|---|
| SAA | Stabilisation and Association Agreement (EU) |
| SABH | Statistical Agency of Bosnia and Herzegovina |
| SAC | Structural Adjustment Credit (World Bank) |
| SAP | Stabilisation and Association Process |
| SBA | Stand-by Arrangement (IMF) |
| SBS | State Border Service |
| SDR | Special Drawing Right |
| SME | Small and medium-sized enterprises |
| SMoU | Supplemental Memorandum of Understanding (EC) |
| TA | Technical assistance |
| USAID | United States Agency for International Development |
| VAT | Value-added tax |
| WB | World Bank |

# Preface

This final report has been prepared by a team from a consortium led by ECORYS Netherlands in association with Economisti Associati (Italy) and CASE (Poland). The European Commission (EC) contracted the ECORYS consortium to conduct an ex post evaluation of EC Macro-Financial Assistance (MFA) provided to Bosnia and Herzegovina in the period November 2002 to February 2006.

The report includes the results of work undertaken in particular during a mission to the International Financial Institutions (IFIs) in Washington DC and two field missions to Sarajevo and Banja Luka, which were conducted in November and December 2006 and February 2007 respectively. We have taken into account the EC's comments and suggestions on the draft report as well as comments by representatives of the Government of Bosnia and Herzegovina and representatives of the two Entities (Federation of Bosnia and Herzegovina and Republika Srpska). The draft version of the report was discussed during a stakeholders' workshop organised in April 2007 in Sarajevo.

We would like to express our special gratitude to all officials in Sarajevo and Banja Luka and other staff and officials in the country, staff members of the International Monetary Fund (IMF) and World Bank in Washington and Sarajevo, and EC officials in Brussels and Sarajevo for their cooperation and willingness to contribute to this evaluation by giving us a good understanding of the facts and events at the time of the MFA operation. We would also like to thank the Steering Committee for its constructive comments and advice during the whole period of this evaluation.

Responsibility for the opinions presented in this final report rests exclusively with the authors and should not be attributed to the Government of Bosnia and Herzegovina or the Governments of the two Entities, the European Commission or the other IFIs.

# Executive summary

## Background

1. This is the final report of the ex post evaluation of Macro-Financial Assistance (MFA) provided to Bosnia and Herzegovina (BiH) in the period November 2002 to February 2006.

2. The goal of MFA was to help to ease the country's external financial constraints, support the balance of payments and secure the reserves position. It also referred to the residual financing gap remaining to be covered after International Monetary Fund (IMF) and World Bank (WB) financing to support the policy objectives attached to the authorities' reform efforts.

3. The MFA comprised a loan element of up to € 20 million and a grant element of up to € 40 million. MFA was disbursed in three tranches, and was divided across the State, the Federation of Bosnia and Herzegovina and the Republika Srpska. In the period 2002-2006, MFA assistance accounted annually for about 2.8% to 5.9% of total financial assistance to BiH. The MFA operation coincided with an IMF Stand-by Arrangement which was in place from August 2002 till February 2004. MFA was explicitly linked to this Stand-by Arrangement.

## Evaluation objectives and approach

4. The main objectives of this ex post evaluation were to: (i) assess the effects of the MFA operation in Bosnia and Herzegovina from November 2002 to February 2006; and (ii) learn key lessons that can be applied in future MFA interventions and/or identify the possible need for a reorientation of the present approach.

5. The evaluation employed six instruments: (i) data collection and analysis; (ii) a literature review; (iii) a preparatory questionnaire to prepare for the structured interviews; (iv) a specially designed 'Delphi technique' (a forecasting methodology based on collective insights and knowledge) questionnaire to assess possible counterfactual scenarios and their effects; (v) structured interviews with key informants; and (vi) macroeconomic modelling. A particular feature of the evaluation approach was the use of the Delphi method, which was selected because of the huge divergence of views and opinions among the various stakeholders about the effects of MFA. The evaluation was based on triangulating all the findings resulting from applying all the evaluation instruments.

6. The evaluation broadly focused on three core areas of effects: (i) macroeconomic stabilisation; (ii) sustainability of the fiscal and external financial situation; and (iii) structural reforms. In addition, the implications of the design and implementation of the MFA operation were considered.

## Impact on macroeconomic stabilisation

7. Bosnia and Herzegovina has received more foreign support per capita than any other country in the world. Sustained inflow of foreign assistance has allowed for rapid economic recovery. During 1996-2000, growth rates of gross domestic product (GDP) were on average above 22%. They fell to an average of 5% in the period 2002-2006. Despite these still high growth rates, nominal GDP in 2005 was below pre-war levels. The Currency Board introduced in 1997 resulted in low inflation rates. These high economic growth rates were accompanied by external imbalances. Large current account deficits above the level observed in other transition countries resulted from large trade deficits of about 50% of GDP. This in turn was caused by limited export potential and strong import growth, fuelled by upward wage growth and domestic credit expansion.

8. Permanent donor support, though diminishing over time, allowed financing of these current account deficits. The international community relieved the country's external financial constraints at a time when forward projections and perceptions showed the need for financial assistance. Together with sustained inflows of remittances from abroad and increased inflows of foreign capital (as banks borrowed from their foreign mother-banks) foreign exchange reserves increased from 3.3 months of imports in 2002 to a projected 4.6 months in 2006.

9. Public revenues amounted to 55.4% of GDP in 2000 because of grants provided for budget support and investments. Despite these inflows, the budget still recorded significant fiscal imbalances. The high but decreasing dependence on foreign funds resulted in a downward fiscal adjustment. Public expenditure declined from 64.5% of GDP in 2000 to an estimated 50.2% in 2005. In 2006, this declining trend was reversed as expenditure increased modestly to 50.6% of GDP. In both 2005 and 2006 fiscal surpluses were recorded.

10. To assess the net impact of European Union (EU) MFA, the most likely counterfactual implementation scenario was constructed, based on responses from the Delphi questionnaire and structured interviews. This scenario involved:
    - no IMF additional financing;
    - no real reason to exert strong pressure on the EU to provide macro support through technical assistance (TA) money;
    - no increased World Bank structural lending;
    - no additional involvement of the donor community;
    - no additional borrowing from private capital markets.

11. In the most likely counterfactual scenario, the burden of adjustment in the short run would have fallen on the shoulders of the BiH Governments, which in all likelihood would have been forced to reduce budgetary expenditure. The BiH policy reaction

would have differed by tranche, but in general could be characterised as: (i) tighter fiscal policy; and (ii) lower accumulation of international reserves. It was assumed that the Government would have had to compensate for lack of alternative financing with available policy instruments. In the fiscal sphere, the lack of MFA would have meant expenditure reductions in 2003 and 2004 and a lack of policy change in 2005-2006 because of fiscal surpluses. Furthermore, the lack of MFA would have resulted in lower import dynamics and lower credit to the private sector. Therefore, MFA resources prevented such developments.

12. According to the results of the Delphi analysis, the *net macroeconomic impact* of MFA can be seen as having supported an overall improvement in macroeconomic stability over the whole period, when both natural dynamics and external support acted in synergy in relieving the situation. The magnitude of MFA's net impact can be considered as non-negligible – about 18-20% of the overall stabilisation effect. A substantial part of these macroeconomic improvements can be attributed to the effects of structural reforms and in particular to indirect tax policy and tax administration reform. The economic modelling results show that the direct effects of MFA have not been sizeable when measured against the main macroeconomic variables such as fiscal balance, international reserves, imports and money supply. However, there are also indirect and cumulative effects which we expected but cannot quantify. Considering both the qualitative and quantitative analyses, it can be concluded that MFA has definitely had positive macroeconomic stabilisation effects on the economy; it has also shaped the perceptions of policymakers and other market players and influenced the perceptions of country risk.

## Impact on external sustainability

13. As mentioned, the inflow of foreign financing contributed to the moderate recovery of gross international reserves from one month of prospective imports in 1998 to 3.3 months in 2002. MFA, other assistance and sustained remittance inflows resulted in further foreign reserve accumulation to 3.8 months of imports in 2005. During the MFA operation, public external debt declined from 39.8% of GDP in 2001 to 30% in 2006. Other debt indicators also showed favourable developments. However, several risks threaten this noticeable achievement, such as significant domestic contingent liabilities estimated to be about 25% of 2005 GDP. These obligations comprise claims on the Government for war damages, individuals' frozen foreign exchange deposits, bank deposits seized during the war, expenditure arrears and privatisation coupons. They would generate an average annual debt service of about 1% of GDP over the medium term. Besides these claims, major risk factors to the country's external sustainability are connected with macroeconomic policy. Large current account deficits, limited sources of financing and variability of remittance flows affect the sustainability prospects for Bosnia and Herzegovina.

14. The baseline external sustainability scenario assumes continued strong growth and low inflation, and access to concessional borrowing, domestic borrowing on commercial terms and privatisation receipts. In this scenario, the external sustainability indicators improve over the medium term.

15. MFA has influenced medium-to-long-term external sustainability through various channels. The primary channel is via macroeconomic stability, and specifically its impact on economic growth. The Delphi analysis showed that respondents assigned a favourable macroeconomic stabilisation role to MFA. This stabilising effect has contributed to the economy's growth foundations. Recent IMF estimates assume that the economy will grow by an annual average of 5.2% until 2011. Furthermore, indirect tax reforms stimulated by the package of external assistance have led to the establishment of a stable and potentially more sustainable budget revenue source. This will enable the country to solve the problem of conditional liabilities in the future without damaging macroeconomic stability.

16. Another channel is through institution building, to which the structural conditionalities of MFA have contributed. The overall package of structural conditions has influenced the sustainability of the reforms by changing the country's institutions, accelerating privatisation and creating a treasury system and an effective custom and tax administration. The reforms in customs and tax policy and administration have contributed to further irreversible reforms like the introduction of valued-added tax (VAT) in 2006. As such, the structural component of MFA has improved the country's growth capacity in the near and medium future.

## Impact on structural reforms

17. MFA included a number of conditionalities, particularly for the second and third tranches, which had to be complied with before disbursement of resources. These conditionalities covered areas like public finance reform and administration, financial sector reform, private sector development and the business environment.

18. The evaluation showed that the MFA conditionalities were considered relevant for the economic conditions of the country when MFA was negotiated. Relevance to the BiH authorities' policy agenda was regarded less unanimously. Some of the conditionalities were not necessarily considered as a real priority by the BiH authorities. Furthermore, some conditionalities were controversial for some of the BiH authorities as they entailed strengthening institutions at state level.

19. The assessment of *gross* impact distinguished between 'formal progress' and 'structural progress'. A conditionality was assessed as having achieved 'formal progress' if it was fulfilled in accordance with the literal formulation of the conditionality. A conditionality was assessed as having achieved 'structural progress' if the reform had become structurally embedded in the BiH institutional context.

20. The Delphi analysis and other evidence showed that formal progress has been fully achieved for most of the conditionalities (12 out of 14). Only for the conditionalities on 'statistics' and 'banking privatisation' was formal progress assessed as 'partly realised'. The number of conditionalities achieving structural progress was lower. Around half of the reforms included in the MFA conditionalities were considered to be structurally embedded in the BiH institutional context in 2006. Public finance and administration reforms and bank privatisation had relatively more structural progress, except in the areas of statistical harmonisation and public procurement.

21. To establish *net* impact, the evaluation examined synergies between the MFA conditionalities and conditionalities included in the EU Stabilisation and Association Process (SAP), the IMF Stand-by Arrangement and various World Bank programmes. None of the conditionalities appeared to be entirely specific to MFA. Most were part of the broader international reform agenda and were also included in the WB and IMF programmes. Some appeared to be specific to the EU strategy as reflected by their synergies with the requirements of the EU-SAP.

22. Three categories of conditionalities could be distinguished as having different *net impacts* (see Table 0.1).

**Table 0.1 Net impact of MFA's structural conditionalities: three categories**

| | Category A | Category B | Category C |
|---|---|---|---|
| **Gross effect of conditionalities** | Structural progress | Formal progress | Formal progress |
| **Degree of synergy of MFA conditionalities with reform agenda of IFIs** | High | Low | High |
| **Degree of ownership among BiH authorities** | High | Low | Low |
| **Conditionalities** | • Treasury<br>• Customs reform<br>• Indirect tax reform<br>• Banking privatisation | • Competition policy<br>• Insurance supervision<br>• Veterinary office<br>• Phytosanitary office | • Large-scale privatisation<br>• Banking supervision<br>• Bankruptcy<br>• Statistics |
| **Net impact of conditionalities** | Acceleration of structural progress | Preparing ground for future structural progress | Negligible net effect |
| | | | |

23. Category A includes conditionalities on treasury system reform, customs and indirect tax reform and banking privatisation. The reform efforts in these policy areas cannot be subscribed solely to MFA, as they were shared with the efforts of the BiH authorities and the broader international community. Nevertheless, MFA has made a contribution to the achievement of structural progress. Most of the conditionalities have contributed to the achievement of short and medium-term macroeconomic objectives. MFA has made its contribution by politically reinforcing the importance of the reforms and, by so doing, accelerating the speed of the reforms.

24. Category B conditionalities relate to competition policy, veterinary and phytosanitary issues and public procurement. Progress in these reform areas should be ascribed to the combined EU efforts of MFA and the SAP programme, as efforts by the BiH authorities and the broader international community on these reform items have been low. As progress in these areas has been limited so far to compliance with the formal conditions, the net impact is characterised as preparing the ground for future structural progress.

25. Category C conditionalities include large-scale privatisation, bankruptcy, banking supervision and statistics. No structural progress has been achieved for these reform items, notwithstanding the synergy of the conditionalities in these areas with external pressure from the international community. The lack of progress can be explained by the low relevance attached to these reform issues by the BiH authorities.

## Implications for design and implementation

26. The MFA operation in BiH was affected by delays in implementation compared with original expectations. This impinged on its possible effectiveness in terms of macroeconomic stabilisation. In one interviewee's words, *'what was supposed to be a one-year operation turned out to be a three-year exercise'*. This was partly because of the BiH Government's difficulties in fulfilling conditionalities, but also because of a series of exceptional operational difficulties with both the EU and BiH legal environments.

27. Regarding genuine ownership of proposed reforms, a critical aspect was that in the case of BiH, the MFA design was not able to make reference to any internal government reform programme as a basis for its proposed structural reforms. The reason for this was that such a document should have been prepared at state level and shared by the two Entities (Federation of Bosnia and Herzegovina and Republika Srpska).

28. According to some interviewees, the fragmented allocation of financing between the different Governments weakened incentives to really implement structural reforms, as the reform burden was carried comparatively more by the Governments of the two Entities, which received a relatively small amount of support in return.

29. In much the same vein, some respondents remarked how funding allocations to the various entities and therefore to the assorted policy areas were too disproportional to their anticipated budgetary costs to represent a real incentive to agree on implementation modalities. Some BiH counterparts seemed to assess the appropriateness of proposed financing by mentally summing up the cost and budgetary consequences of proposed reforms in each policy area.

30. The MFA grant component in BiH represented a decisive, though extraordinary, incentive because unlike typical TA, the MFA was perceived as horizontal budgetary support *'benefiting all, and not only a given department or unit within Government'*. On the contrary, the loan was often (though erroneously) perceived as being provided *'on commercial terms'* by BiH counterparts apparently unaware of any potential credit constraints on them.

31. Concerning operational synergies with other EU or International Financial Institution (IFI) programmes, it was noted that MFA was assigned based on the somewhat implicit presumption that the Government would inform all its branches about the agreed policy reform agenda so that they could respond accordingly. While such coordination and information sharing certainly existed at the political Council of Ministers level, communication mechanisms further down the hierarchical chain

were, however, not so obvious. Instances were found of top civil servants who were poorly informed about MFA and its link with the activities under their area of responsibility.

32. Monitoring of MFA in BiH proved quite difficult, especially in its early phases. This was mainly because of the lack of secondary sources and the need to consolidate primary data from the Entities. In the beginning, the Governments in BiH were inadequately equipped and totally lacked experience to cope with the task.

33. In the period concerned, the overall policy reform agenda of the Governments in BiH included as many as 100 to 150 structural conditionalities, from various sources. To many interviewees this pointed to the need to (i) simplify and (ii) better tailor conditions in the light of a realistic assessment of both willingness and local implementation capacity. However, too much reinforcing of conditionalities should be avoided, for purely practical reasons. It would be extremely difficult to devise a coordinated monitoring mechanism; each IFI would end up making the same requests to different government institutions on the same subjects.

34. Regarding the appropriateness of multiple strategic objectives for the same MFA instrument, it was generally acknowledged that MFA to BiH would have had the additional objective of supporting the establishment of institutions at state level, also as a way to prepare for incorporating the *acquis* (EU body of law). In a number of cases, the bulk of resistance to transferring policy responsibilities to state-level institutions as part of a nationwide state-building exercise was found in one Entity.

35. From the analysis and conclusions, this final report contains a number of recommendations for future use of the MFA instrument, based on this specific evaluation of MFA to BiH. These recommendations refer to MFA objectives, timeliness of disbursement, number of conditions, composition of MFA, political ownership and communication matters.

# 1 Introduction

This is the final report of the ex post evaluation of Macro-Financial Assistance (MFA) provided to Bosnia and Herzegovina (BiH) in the period November 2002 to February 2006.

The particular objective of the final report is to present the evaluation's findings and the conclusions of the evaluation. Additionally, it provides recommendations as input for a meta-evaluation of the MFA instrument. This final report follows closely the evaluation questions, which accord with the *Guidelines for the ex post evaluation of MFA operations* of the Directorate General for Economic and Financial Affairs (DG ECFIN) .

The report is structured as follows. Chapter 2 outlines the evaluation objectives and approach towards the ex post evaluation. Chapter 3 presents a historical overview of relevant MFA events and describes the background to the MFA operation. The succeeding chapters then look at the main evaluation areas: impact on macroeconomic stabilisation, impact on external sustainability and impact on structural reforms. Chapter 4 analyses macroeconomic developments in Bosnia and Herzegovina. It also discusses the results of a specially designed questionnaire to understand and determine the effects of the counterfactual scenario, enabling assessment of the net effects of MFA. Chapter 5 presents a forward-looking analysis of the impact on external and fiscal sustainability. Chapter 6 discusses the impact of MFA on structural reforms. Chapter 7 sets out case studies that provide in-depth analyses of the cause-and-effect relations of three selected structural conditions. Finally, Chapter 8 considers the implications of the design and implementation of the operation on its efficiency and effectiveness. It contains recommendations for potential future MFA operations, in order to increase the instrument's efficiency and effectiveness.

# 2 Evaluation objectives and approach

## 2.1 Purpose of the evaluation

Under its Financial Regulation (Article 27.4), the European Commission (EC) is legally obliged to evaluate its key programmes, including MFA. Furthermore, an ex post evaluation of MFA to Bosnia and Herzegovina was announced in the Memorandum of Understanding (MoU) and Supplementary Memorandum of Understanding (SMoU) concluded between the European Commission and the BiH authorities.[1]

The main objectives of this ex post evaluation of MFA were to: (i) assess the effects of the MFA operation in Bosnia and Herzegovina from November 2002 to February 2006; and (ii) learn key lessons that can be applied to future MFA interventions and/or identify the possible need for a reorientation of the present approach. The evaluation was therefore both backward and forward looking. Any lessons will contribute to the anticipated meta-evaluation of MFA.[2]

## 2.2 Evaluation approach and methods

The ex post evaluation was based on five broad evaluation questions. Table 2.1 presents these questions as stated in the terms of reference. They accord with the DG ECFIN *Guidelines for the ex post evaluation of MFA operations*.

**Table 2.1 Generic evaluation questions from the *Guidelines***

| No. | Evaluation question |
|---|---|
| Q1 | To what extent has the MFA been effective in terms of the short-term macroeconomic stabilisation of the country concerned? |
| Q2 | To what extent has the MFA been effective in terms of supporting structural reform? |
| Q3 | What have been the indirect and/or unexpected effects of the MFA? |
| Q4 | To what extent has the MFA contributed to returning the external financial situation of the country concerned to a sustainable path over the medium to longer term? |
| Q5 | How has the way in which the MFA operation was designed and implemented conditioned its effectiveness and efficiency? |

1 *'An independent ex post evaluation of the assistance may be carried out by the Commission or duly authorised representatives. The authorities of the Country are committed to supply all necessary information. The evaluation report will be made available to them for comments.'*

2 The lessons will be added to those based on the ex post evaluations of MFA to Romania and the Former Yugoslav Republic of Macedonia carried out between November 2005 and July 2006, and the recommendations included in the final report of the ex post evaluation of EFA to Tajikistan.

The evaluation questions broadly focused on three core areas of effects:
1. Macroeconomic stabilisation;
2. Sustainability of the external financial situation;
3. Structural reforms.

These areas focused on the short, medium and long-term effects of the MFA operation respectively, over specific time horizons. Macroeconomic effects were assessed up to two years after the initial disbursement; sustainability of the external financial situation up to three years or more after the initial disbursement; and structural effects on the economy and institutions up to four years after the initial disbursement.

Table 2.2 shows the three core areas of the evaluation corresponding to Chapters 4-6 of this report. It indicates how they can be traced back to the evaluation component and the sub-evaluation questions from the *Guidelines*.

**Table 2.2 Core areas of evaluation, time horizons, evaluation approach and evaluation components**

| Core areas | Time horizon | Evaluation approach | Evaluation components | Evaluation questions from *Guidelines* |
|---|---|---|---|---|
| Chapter 4: Macroeconomic stabilisation | Short-term: up to two years after disbursement | Quantitative analysis; Qualitative analysis of counterfactual using Delphi method; Modelling | • Objectives<br>• Actual development<br>• Counterfactual objectives<br>• Counterfactual outcomes<br>• Net effect<br>• Indirect effects<br>• Unexpected effects<br>• Instrument design | Q 1.1<br>Q 1.2<br>Q 0.1<br>Q 0.2<br>Q 1.3<br>Q 3.1<br>Q 3.2<br>Q 5.1 |
| Chapter 5: External sustainability | Medium term: three or more years after disbursement | Modelling; Qualitative assessment of future risks | • Actual development<br>• Main factors<br>• Indirect effects<br>• Sustainability prospects | Q 4.1<br>Q 4.2<br>Q 4.3<br>Q 4.4 |
| Chapter 6: Structural reforms | Short and medium term: up to four years after disbursement | Qualitative analysis, supported by assessment of structural effect indicators | • Objectives<br>• Relevance<br>• Actual development<br>• Counterfactual objectives<br>• Counterfactual outcome<br>• Net effect<br>• Complementarities<br>• Unexpected effects<br>• Instrument design | Q 2.1<br>Q 2.2<br>Q 2.3<br>Q 0.1<br>Q 0.2<br>Q 2.4<br>Q 2.5<br>Q 3.2<br>Q 5.1 |

To attribute effects to the MFA operation in BiH, we followed a three-step approach in accordance with the *Guidelines for ex post evaluation of MFA*. The *first step* was to identify the types of short-term macroeconomic effects and short and medium-term structural effects on the economy and on institutions, and plausible cause-and-effect relations between the assistance and its effects. The *second step* was to establish a counterfactual scenario, and the *third step* involved determining the net effect of the operation – i.e. for the macroeconomic and structural impacts, the difference between the observed effects and the possible effects of the counterfactual scenario.

To measure the net effects of the MFA intervention we used the 'Delphi' method. Section 2.3 describes in more detail the Delphi technique used. Using this evaluation method, we were able to identify and establish qualitatively possible counterfactual scenarios and related possible effects as perceived by interviewees. An economic model was used to quantify the macroeconomic counterfactual scenario; section 2.4 explains the modelling approach. By comparing the effects of the counterfactual scenario with the actual outcomes, the net effects of the MFA intervention were established. In the case of impact on external sustainability, we did not explicitly elaborate a counterfactual scenario, but examined channels of potential and actual impact. Unexpected and indirect effects, as well as consequences of programme design and implementation, were also analysed.

Two case studies have been elaborated to understand in depth the cause-and-effect relations between the structural conditions and the observed structural developments. This approach will contribute to better understanding of progress on structural reform in BiH.

The evaluation employed six *main evaluation instruments*:
- data collection and analysis;
- a literature review;
- a preparatory questionnaire to prepare for the structured interviews;
- a specially designed 'Delphi' questionnaire to assess possible counterfactual scenarios and their possible effects;
- structured interviews with key informants;
- macroeconomic modelling.

The evaluation was based on triangulating all the findings that resulted from applying all these evaluation instruments.

## 2.3 The Delphi method to establish counterfactual scenarios

*Methodological difficulties in using standard approaches*
The counterfactual scenario is an estimate of what could have occurred in the absence of MFA. Counterfactuals are usually derived through methodologies based on comparison groups and modelling, but adapting these techniques to the BiH case would have had notable limitations. First, the nature of MFA does not lend itself to identifying any comparison group at country level. Moreover, Bosnia and Herzegovina is unique in several institutional, macroeconomic and political aspects.

Modelling also faces major limitations. First, it would be necessary to run a model simulating what actually occurred in reality and identify detailed mathematical relations describing causal relations and explanatory factors. Then it would be necessary to run the same model based on a set of assumptions representing a 'without intervention' scenario. However, even simple models cannot really be validated in the case of BiH. The country has undergone too many structural shocks in a short period of time to assume stable coefficients and elasticities. Furthermore, the lack of sufficient observations and the low quality – and therefore low reliability – of macro-data inhibit a sound modelling approach.

Therefore, another method was employed for this evaluation. The modelling approach was still used, but complemented by the so-called 'Delphi technique'.

*Delphi technique*

An alternative qualitative approach is to rely on *judgemental* estimates such as those envisaged in the Delphi technique, which is ultimately a forecasting methodology based on respondents' insights[3] and collective knowledge. The Delphi method uses an iterative questionnaire survey that can be adapted to gain informed forecasts from past events. Our adaptation envisaged a combination of:

1. estimates of the *subjective* probability attached to the occurrence of particular events;
2. issue-items requesting ranking by respondents according to *importance*;
3. goal-items about the *desirability* of certain options; and
4. options-items requesting respondents to identify *alternative* courses of action.

Delphi is an anonymous iterative process carried out in several steps. It aims to structure conflicting and dissenting views, with a view to reaching a final consensus. The Delphi exercise used in this evaluation comprised two steps. The first was carried out during the first field mission in BiH and Washington DC, and preliminary results were presented in the intermediate report. In the second step, all respondents were given a second-round questionnaire that included consolidated results, to enable them to comment on possible dissenting views. They were allowed, if they felt the need to do so, to explain, reassess or even change their responses.

A copy of the questionnaire is given in Annex 1. The questionnaire was submitted to a sample of 30 informed respondents from a dozen institutions: the EC delegation, Office of the High Representative, International Monetary Fund (IMF), World Bank (WB), BiH Central Government, the Entities' Governments, the Central Bank, and the donor community.[4] They were selected to ensure that different and potentially conflicting positions – International Financial Institution (IFI) community, beneficiary BiH Governments, state level, Entities level – could be represented to the highest extent possible. Moreover, in line with Delphi best practice, the survey was arranged to include as far as possible different roles in terms of organisation represented, degree of influence and level of seniority. The aim was to receive at least 10 responses, which is the lowest validity threshold in terms of number of respondents for a Delphi exercise. The final sample included 14 questionnaires from a well-balanced group of respondents from different institutions.[5] During the second field mission in BiH, interviews were held with some of the other 16 'missing' respondents, who had either filled in the questionnaire but did not return it in time, or could not find time to respond. These interviews were used to validate and comment on the findings, but were not included in the Delphi statistics.

[3] Econometric models are also implicitly dependent on judgemental forecasting, though this aspect is often sidelined to make them appear 'objective' exercises.

[4] This figure is generally considered the highest possible range for a Delphi evaluation exercise.

[5] The list of respondents is not reported here, for obvious confidentiality reasons.

### *Limitations of the Delphi technique*

The Delphi technique is based on perceptions and insights, so it suffered from the kinds of inevitable shortcomings and cognitive biases that affect all subjective assessment techniques, such as:

- small probabilities being difficult to assess;
- strategic answering (respondents answering to influence the future possible use of this report, or for diplomatic or courtesy reasons, rather than expressing their genuine views);
- the counterfactual being retrospective, so that respondents already had a mindset of relations and associations, impairing really creative guessing and radically alternative thinking.

This last point is particularly worth highlighting, as respondents inevitably tended to be biased by the *actual* course of events and perceived causal relationships accordingly. It is a feature of human thinking that the rationale behind selecting counterfactuals is that of *comparative similarity* between worlds or scenarios, and the actual past is a very powerful framework.

During implementation of this evaluation exercise, two main difficulties arose. First, a number of respondents, although privileged informants about MFA, proved to be familiar with only certain aspects of the operation. They were therefore reluctant to comment on the instrument as a whole, or were uneasy about speculating on broader links or elaborating on broader scenarios. Civil servants, in particular, were concerned that their views could be misconstrued as being the views of the institution they belonged to; in certain cases they proved particularly cautious.

Secondly, since the exercise was run retrospectively, it lacked the genuine element of educated guesswork that Delphi is based on. The views expressed tended to be well rooted and fairly firm opinions, rather than tentative assessments subject to refinement. As a result, a much lower than usual number of respondents decided to modify or change their opinions in the second round than would usually be the case. Moreover, as a further MFA operation in the country was generally deemed unlikely, this deprived the exercise of any concrete direct interest for most respondents. They could see in it little more than an academic exercise of small concern to them other than the intellectual curiosity of seeing the average answers.

### *Assumptions made*

In order to conduct the counterfactual analysis, some assumptions were made concerning the distinction between *'variables'* and *'context-fixed conditions'*. The latter were defined as all those 'arrangements' or policies not supposed to be within the scope of MFA itself. For instance, the existence of a Currency Board was taken as a given, as well as the regulatory framework for movement of capital or financial transactions with other countries. These were strong assumptions, as the lack of an emergency instrument in an emergency situation would likely lead to emergency measures, therefore radically changing the context itself and the overall framework of policies.

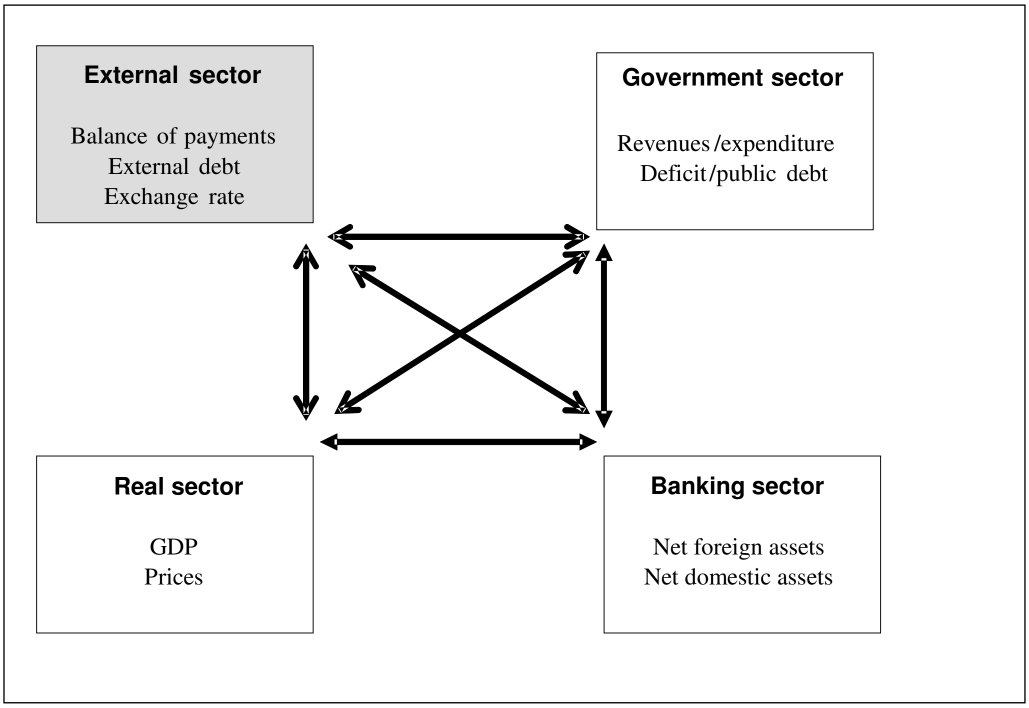
Finally, a counterfactual scenario depends not only on *whether* a given event might occur, but also on *when* and *how*. For the sake of analysis, in this instance it was assumed that the alternative event could have occurred at more or less the same moment in time or in the same manner as the actual one.

## 2.4 Economic modelling approach

As mentioned in section 2.2, we used an economic model to quantify the macroeconomic effects of the counterfactual scenario. We applied a similar approach to that developed for the MFA evaluations for Romania and the Former Yugoslav Republic of Macedonia. However, the method was adapted to account for specific characteristics of the BiH economy.

The economic effects of the counterfactual scenario were modelled in a consistency framework providing for interrelations among different sectors of the economy: real, budgetary, external and banking (see Figure 2.1). This model was calibrated using data available from IMF International Finance Statistics and recent IMF country reports.

**Figure 2.1 Basic structure of the economic model, which recognises links and ensures consistency among four basic economic sectors: real, external, government and banking**




The economic consequences of the counterfactual scenario were analysed using annual data, with special attention paid to the separate tranches.

## 2.5 Evaluation difficulties

The main difficulties encountered during the evaluation related to: (i) availability and quality of data; (ii) receiving sufficient and timely feedback on the Delphi questionnaire(s); and (iii) political sensitivities between the two Entities in BiH.

These factors complicated this MFA evaluation.

Severe shortcomings in statistical data at both state and entity level made the evaluation difficult. This problem with data was confirmed by various interviewees in Brussels, Washington DC and Sarajevo. Therefore, this evaluation relied less on the quantitative modelling approach compared with previous MFA evaluations.

There was also a considerable risk that we would obtain insufficient responses from the Delphi questionnaires. In the end we received sufficient responses (as mentioned in section 2.3), after various reminders and extending deadlines for submitting completed questionnaires. Hence a time period longer than anticipated was required to produce the final evaluation report.

Furthermore, the complex political structure of Bosnia and Herzegovina complicated the cause-and-effect analysis of MFA, particularly as MFA funds were divided between the State and the two Entities within Bosnia and Herzegovina.

To a large extent, the structured interviews concentrated on gathering rational views. The two rounds of interviews in Sarajevo and Banja Luka showed that emotions and sentiments at entity level regarding the country's political and economic development were still enormous. In a few instances, interviewees' answers were a mixture of rational views and emotional responses. We took this into account in our analysis.

Despite these difficulties, this evaluation was a very challenging and interesting task. We benefited from cooperation, support and insights from all main stakeholders involved in the MFA operation. This allowed us to analyse the facts and events, resulting in our conclusions and recommendations.

# 3 Background to the MFA operation in Bosnia and Herzegovina

## 3.1 History of the BiH MFA operation

In November 2002, the European Union (EU) Council approved Macro-Financial Assistance of up to € 60 million to Bosnia and Herzegovina (Council Decision 2002/883/EC). The Council Decision explicitly stated that MFA was an appropriate measure to help to ease the country's external financial constraints, support the balance of payments (BoP) and secure the reserve position. Furthermore, it referred to the residual financing gap that remained to be covered (after IMF and World Bank financing) to support the policy objectives attached to the authorities' reform efforts. It was also considered that financial assistance should be instrumental in bringing Bosnia and Herzegovina closer to the European Community.

The MFA comprised a loan element of up to € 20 million and a grant element of up to € 40 million. It was disbursed in three tranches and was divided over the State, the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS). Table 3.1 provides an overview of this partition.

**Table 3.1 Division of the three MFA tranches within Bosnia and Herzegovina (in € millions)**

| Tranche | Loan/grant | State | Federation BiH | RS |
|---|---|---|---|---|
| 1st tranche | € 15 grant | € 3.75 grant | € 7.5 grant | € 3.75 grant |
| 2nd tranche | € 10 grant | € 5 grant | € 3.33 grant | € 1.67 grant |
| | € 10 loan | | € 6.66 loan | € 3.33 loan |
| 3rd tranche | € 15 grant | € 7.5 grant | € 5 grant | € 2.5 grant |
| | € 10 loan | | € 6.66 loan | € 3.33 loan |
| **Total grant** | **€ 40 grant** | **€ 16.25 grant** | **€ 15.83 grant** | **€ 7.92 grant** |
| **Total loan** | **€ 20 loan** | | **€ 13.32 loan** | **€ 6.66 loan** |
| | | | | |

Of the first tranche, 25% was made available to the State and the rest was allocated on a one-third/two-thirds basis between the Republic Srpska and the Federation of Bosnia and Herzegovina. Of the second and third tranches, the State received 50% of the € 10 million grant. The remainder of the grant and the loan were allocated on a one-third/two-thirds basis between the RS and FBiH. The one-third/two-thirds distribution rule was derived from the Constitution of Bosnia and Herzegovina.[6]

[6] Such as the distribution of seats in both Houses of Parliament.

The MFA operation was expected to last 15 months from November 2002 until February 2004 in line with the IMF Stand-by Arrangement (SBA). However, the actual disbursement of the tranches experienced some delay (see Table 3.2).

**Table 3.2 The three tranches of the MFA operation in Bosnia and Herzegovina approved in November 2002**

| Tranche | Date of disbursement | Loan/grant | Condition |
|---|---|---|---|
| 1st tranche | February 2003 | € 15 million grant | Approval of IMF SBA, signing of MoU |
| 2nd tranche | December 2003<br>January 2004 | € 10 million grant<br>€ 10 million loan | Conditions of MoU fulfilled, signing of SMoU |
| 3rd tranche | July 2005<br>February 2006 | € 15 million grant<br>€ 10 million loan | Conditions of SMoU fulfilled, additional prior actions fulfilled |
| | | | |

The *first tranche* was released in February 2003. Disbursement of the first tranche of € 15 million grant followed the approval of a Stand-by Arrangement with the IMF and signing of a Memorandum of Understanding which laid out the conditions attached to the first and second tranches.

The *second tranche* was released in December 2003 (grant part) and January 2004 (loan part). It was disbursed after the conditions of the MoU were fulfilled and the (prior) conditions formulated in the Supplemental MoU for the second tranche were approved. This tranche experienced some hold-up because of:

- delays in implementing the required policies;
- delays by the BiH Parliament in ratifying the loan agreement;
- the need to amend the SMoU to comply with the obligations of the new EC Financial Regulation.

The original Council Decision expired in November 2004 while the *third tranche* of € 25 million was still outstanding. Therefore, in December 2004 the Council approved an extension of the assistance until 30 June 2005 (Council Decision 2004/861/EC). The grant part of € 15 million was finally disbursed in July 2005, while the loan part of € 10 million was released in February 2006. Hold-ups in disbursing the third tranche were because of:

- delay in disbursement of the second tranche;
- delays in implementing the conditions of the SMoU;
- fulfilment of additional conditions based on the conclusions of an Operational Assessment (OA) conducted in August 2004. This OA examined the administrative procedures and financial circuits of organisations (Ministry of Finance and Central Bank) and processes involved in MFA, to ensure that the country maintained a sufficient control environment.[7]

[7] This did not affect the loan part (€ 10 million) so much, as the additional conditions were already fulfilled at the time of disbursement of the grant component. Late ratification of the loan agreement by the BiH Parliament delayed disbursement of the loan component.

## 3.2 Relative importance of MFA

Table 3.3 presents total financial assistance to Bosnia and Herzegovina in the period 2002 to 2006. It shows that in the years when the MFA tranches were disbursed, MFA assistance accounted annually for 2.8% to 5.9% of total financial assistance.

**Table 3.3 Quantitative analyses of total MFA for Bosnia and Herzegovina (in € millions)**

| | 2002 | 2003 | 2004 | 2005 | 2006 projected |
|---|---|---|---|---|---|
| **Total support** | **261** | **351** | **299** | **252** | **244** |
| Official transfers (including MFA grant element) | 35 | 170 | 137 | 116 | 116 |
| Loan disbursements (including MFA loan element) | 226 | 181 | 162 | 136 | 128 |
| *EU MFA* | *15* | *10* | *10* | *15* | *10* |
| • *Loan* | - | - | *10* | - | *10* |
| • *Grant* | *15* | *10* | - | *15* | - |
| **EU MFA as % of total** | **5.7** | **2.8** | **3.3** | **5.9** | **4.1** |

Sources: IMF Country Reports No. 06/371 (for 2003-2006) and No. 05/199 (for 2002), and EC report on the implementation of MFA to third countries (2003)

Tables 3.4 and 3.5 show IMF and World Bank support to BiH from 2002 to 2004. The country successfully completed the IMF Stand-by Arrangement in February 2004 (the SBA started in August 2002). The SBA was prolonged for three months beyond its initially foreseen completion date of November 2003.

**Table 3.4 Last IMF Stand-by Arrangement**

| Name | Date of arrangement | Date of expiration | Amount (in millions Special Drawing Rights (SDR)) | Amount drawn (in millions SDR) | Comments on completion |
|---|---|---|---|---|---|
| SBA | 2 August 2002 | 28 February 2004 | 67.60 | 67.6 disbursed in 3 tranches:<br>2002: 12.0 million<br>2003: 24.0 million<br>2004: 31.6 million | Four reviews completed. 100% used. |
| | | | | | |

The BiH Government and the IMF have not (yet) agreed on a new SBA. Many inside and outside observers have emphasised the importance of a new IMF arrangement for the country as an instrument to encourage the conduct of sensible macroeconomic policies and instil fiscal discipline.

Table 3.5 World Bank Structural Adjustment Programmes

| Bosnia and Herzegovina | Credit (in $ millions) | Tranches* (in $ millions) | Start of project | End of project |
|---|---|---|---|---|
| Public Finance Structural Adjustment Credit II** (PFSAC) | $ 72 | 3 tranches | June 1999 | December 2002 |
| Social Sectors Adjustment Credit II | $ 51 | 2 tranches of 24 and 27 respectively | June 2004 | June 2006 |
| Economic Management Structural Adjustment Credit (EMSAC) | $ 34 | 2 tranches of 10 and 24 respectively | June 2004 | Ongoing |
| Business Enabling Environment Structural Adjustment Credit (BAC) | $ 44 | 2 tranches of 19 and 25 respectively | May 2002 | Ongoing |
| | | | | |

* Some WB credits contain(ed) provisions concerning distribution of the tranches over the State and the two Entities.

** Including co-financing by the Netherlands ($ 27 million) and Switzerland ($ 3 million). This credit had only a small time overlap with the MFA operation.

# 4 Impact on macroeconomic stabilisation

## 4.1 Introduction

This chapter analyses the MFA's effects on macroeconomic stabilisation. Table 4.1 shows the related evaluation questions.

**Table 4.1 Relevant evaluation questions for analysing the impact of MFA on macroeconomic stabilisation**

| | Impact on macroeconomic stabilisation |
|---|---|
| Q1.1 | What are the short and medium-term macroeconomic objectives of the assistance? |
| Q1.2 | To what extent have the short and medium-term macroeconomic objectives of the assistance been achieved? |
| Q0.1 | What arrangements would have been implemented if the MFA had not been granted? |
| Q0.2 | What are the structural and macroeconomic effects of the most likely implementation scenario(s)? |
| Q1.3 | What has been the contribution of the grants and/or loans provided by the MFA operation to the achievement of MFA objectives? |
| Q3.1 | What, if any, has been the contribution of actions arising as a result of the structural conditionality criteria to the achievement of the short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)? |
| Q3.2 | Has the assistance given rise to any unexpected short and medium-term macroeconomic effects? What were they and how did they occur? |
| | |

The following sections present the main evaluation findings.

## 4.2 Macroeconomic objectives of the intervention and their relevance

*Q1.1: What are the short and medium-term macroeconomic objectives of the assistance?*

### 4.2.1 Macroeconomic objectives

Article 1 of the Council Decision of 2002 explicitly stated the goal of the MFA assistance as '… *ensuring a sustainable balance-of-payments situation and securing the country's reserve position*'. The Memorandum of Understanding mentioned the objectives linked to this goal, namely to: ease the country's external financing constraints, support the balance of payments and secure the foreign exchange reserve position. The MoU also stated that assistance was complementary to the resources provided by IFI and bilateral donors in support of the authorities' economic reform programme. Thus, support for the Government's reform programme was another MFA objective. All these objectives are summarised in Table 4.2.

**Table 4.2 Explicit objectives of MFA assistance**

| | Objectives | Source |
|---|---|---|
| **Explicit objectives** | | EU Council Decisions 2002/883/EC and 2004/861/EC, and MoU and Supplemental MoU |
| 1 | To ease the country's external financing constraints | |
| 2 | To support the balance of payments | |
| 3 | To secure the foreign exchange reserve position | |
| 4 | To support the Government's reform programme | |
| | | |

In August 2002, the IMF approved a 15-month Stand-by Arrangement for BiH to support the authorities' economic programme in 2002-2003. MFA was explicitly linked to this IMF Stand-by Arrangement. The Council Decision of 2002 stated that the first instalment of MFA would be released on the basis of satisfactory implementation of the SBA. The second and any further instalments would be released on the basis of a satisfactory track record on the country's adjustment and reform programme, and not before one quarter after the release of the previous instalment. Given this explicit link to the IMF programme, we conclude that the MFA replicated the objectives of the IMF arrangements in terms of macroeconomic stabilisation.

In addition to these explicit goals and objectives, implicit and more specific structural objectives can be determined. These implicit objectives can be traced back to the MFA structural conditions (see Chapter 6). A number of interviewees considered them as principal objectives of MFA. Some interviewees perceived as a principal objective the support of BiH's public finances, particularly those at state level.

For the purposes of this evaluation, we identified the short-term macroeconomic objectives of the MFA assistance as being similar to those of the IMF programme, whereas the medium-term objective was to assure both fiscal and external sustainability.

In operational terms, the MoU specified that the proceeds of the assistance would be allocated to the budgets of the Federation of BiH, the Republika Srpska and the state budget. The funds would be deposited at the Central Bank in a separate account. The proceeds would be kept in this account until they were used to finance budgetary expenditure, in particular to service external debt.

The next section of this evaluation examines to what extent the MFA assistance was used to increase gross international reserves and/or finance budgetary expenditure.

### 4.2.2 Effect indicators

MFA was closely linked to the IMF Stand-by Arrangement. We assumed that the MFA's macroeconomic objectives corresponded with the objectives of the SBA in terms of macroeconomic stabilisation.

The SBA approved in August 2002 was successfully completed in February 2004. Fulfilment of the SBA was generally in line with the original schedule, though there were some delays in completing the second and third reviews. These delays were caused by non-observance of two performance criteria and one structural benchmark for the end of

December 2002 concerning gross borrowing by FBiH cantons and municipalities, and RS extra-budgetary funds.

The goal of the IMF arrangement was to achieve medium-term fiscal sustainability and provide access to foreign financing. The specific targets set for macroeconomic variables are presented in Table 4.3. Differences in economic performance between the two Entities meant that some of these objectives were set separately for each Entity.

**Table 4.3 Selected macroeconomic objectives of the 2002 IMF SBA**

| Macroeconomic indicators | SBA 2002 original estimates for 2002 | SBA 2002 original estimates for 2003 |
|---|---|---|
| **Real growth in gross domestic product (GDP) (% change)** | 2.3 | 4.1 |
| Federation of BiH | 3.2 | 5.6 |
| Republika Srpska | 0.0 | 0.5 |
| **Consumer Price Index (CPI) (annual average)** | | |
| Federation of BiH | 1.5 | 1.6 |
| Republika Srpska | 4.4 | 2.5 |
| **Fiscal balance (% BiH GDP, commitment basis)** | | |
| Federation of BiH | -1.8 | 0.1 |
| Republika Srpska | -0.2 | 0.0 |
| **Current account (excl. official transfers, % GDP)** | -21.3 | -18.7 |
| **Gross reserves (millions of US$)** | 1,572 | 1,622 |
| In months of merchandise imports | 6.4 | 6.3 |
| **External debt (% GDP)** | 62.0 | 61.4 |

Source: IMF Country Report No. 02/191, p24

The quantitative performance criteria and indicative targets in the SBA would support realisation of the underlying macroeconomic objectives of the arrangement. Table 4.4 provides a summary of these performance criteria and targets.

**Table 4.4 Quantitative performance criteria and indicative targets in the IMF SBA of 2002 (in millions of KM (Convertible Marka))**

| | 2002 | | | | 2003 | |
|---|---|---|---|---|---|---|
| | End-Mar* | End-June* | End-Sep** | End-Dec** | End-Mar* | End-June* |
| **Ceiling on gross credit of the banking system to the consolidated general government** | | | | | | |
| State Government | 0 | 0 | 0 | 0 | 0 | 0 |
| RS Government and municipalities | 10 | 10 | 10 | 10 | 10 | 10 |
| RS extra-budgetary funds | 2 | 2 | 2 | 2 | 2 | 2 |
| Federation Government*** | 20 | 20 | 20 | 20 | 20 | 20 |
| Federation cantons | 10 | 10 | 10 | 10 | 10 | 10 |
| Federation municipalities | 8 | 8 | 8 | 8 | 8 | 8 |
| Federation extra-budgetary funds | 0 | 0 | 0 | 0 | 0 | 0 |
| **Ceiling on contracting or guaranteeing of new concessional external debt with original maturity of more** | | | | | | |

| | 2002 | | | | 2003 | |
|---|---|---|---|---|---|---|
| | End-Mar* | End-June* | End-Sep** | End-Dec** | End-Mar* | End-June* |
| **than one year by the public sector** | | | | | | |
| | 0 | 445 | 445 | 445 | 445 | 445 |
| **Ceiling on contracting or guaranteeing of new non-concessional external debt by the general government of the public sector** | | | | | | |
| | 0 | 0 | 0 | 0 | 0 | 0 |
| **Ceiling on new external debt owed by the consolidated general government or guaranteed by the public sector with an original maturity of up to and including one year** | | | | | | |
| | 0 | 0 | 0 | 0 | 0 | 0 |
| **Ceiling on outstanding external payments arrears******** | | | | | | |
| | 0 | 0 | 0 | 0 | 0 | 0 |

Source: IMF Country Report No. 02/191, p63

*Targets are indicative.

**Targets for end-September and end-December are performance criteria.

***Excluding letters of credit at the state level for CIPS financing up to KM 40 million.

****This applies on a continuous basis.

For the purpose of monitoring the EU MFA conditions, the MoU and SMoU required periodically updated quantitative data on a number of fairly common macroeconomic indicators (Box 4.1).

### Box 4.1 List of monitoring indicators

Price indicators
GDP, industrial production and investment
Employment, unemployment and wages
Transfers by Entities to the state budget and possible arrears
Level and composition of government revenue and expenditure
Accumulation of arrears of government payments
Foreign trade at countrywide and entity levels
Foreign debt service payments, debt levels and external arrears
Balance of payments and international reserve position

Apart from the quantitative performance criteria and indicative targets under the IMF programme, these macroeconomic indicators set for monitoring purposes were not accompanied by benchmarks or targets. We assume that explicit targets were not deemed necessary since the IMF Stand-by Arrangement already contained measurable macroeconomic objectives. Table 4.5 presents the macroeconomic indicators used to assess progress in achieving macroeconomic stabilisation.

**Table 4.5 Macroeconomic indicators**

| Macroeconomic stabilisation | Effect indicator |
|---|---|
| **Macroeconomy (state and entity level)** | GDP growth rates<br>Inflation |
| **Public finance (state and entity level)** | Level of government revenue<br>Grants<br>Level of government expenditure<br>Fiscal deficit<br>Primary balance<br>Financing of the deficit |
| **Balance of payments** | Current account deficit<br>Inflow of foreign direct, portfolio and other investment<br>International reserves |
| **Financial volatility and BoP sustainability** | Domestic and foreign debt<br>Debt service payments<br>Commercial banks' claims |

## 4.3 Gross impact – actual macroeconomic outcomes

*Q1.2: To what extent have the short and medium-term macroeconomic objectives of the assistance been achieved?*

### 4.3.1 The starting point

The Dayton Peace Agreement signed in December 1995 put an end to four years of war in BiH and established a multi-layer administrative structure comprising the State, two Entities (Federation of BiH and Republika Srpska) and the autonomous Brčko District. The newly established Entities had different growth rates, inflation and fiscal policies; coordination at central level was limited. New instruments and institutions allowing for economic integration were gradually introduced, such as the Currency Board in 1997 and the Indirect Tax Authority (ITA) in 2003.

Bosnia and Herzegovina has received more foreign support per capita than any country in the world. Sustained inflow of foreign assistance allowed for rapid economic recovery (see Table 4.6). However, high economic growth rates were accompanied by external imbalances. As foreign aid gradually declined, economic growth decelerated, but labour-market distortions and external imbalances remained sizeable. In order to support medium-term growth, the external financing gap had to be covered and restructuring processes accelerated to increase the production and export capacity of domestic companies. Facing these demands, the international community provided financial assistance; the EU's MFA was one component of this package.

**Table 4.6** **Main macroeconomic indicators for Bosnia and Herzegovina, 2002-2006**

| | 2002 | 2003 | 2004 | 2005 (estimated) | 2006 (projected) |
|---|---|---|---|---|---|
| **Macroeconomic indicators** | | | | | |
| GDP growth (%) | 5.0 | 4.1 | 5.8 | 5.0 | 5.5 |
| CPI (period average) | 0.3 | 0.6 | 0.2 | 2.8 | 6.5 |
| Real effective exchange rate (2000 = 100, increase = appreciation) | 95.1 | 95.4 | 94.4 | 93.4 | … |
| | | | | | |
| **Fiscal indicators** | | | | | |
| Government overall balance (% GDP) | -3.3 | -2.0 | -0.4 | 0.9 | 0.7 |
| Public debt (% GDP) | 34.8 | 30.6 | 28.1 | 31.7 | 48.2* |
| | | | | | |
| **Balance of payments** | | | | | |
| Current account balance (% GDP) | -19.1 | -20.9 | -19.3 | -21.3 | -17.0 |
| Gross official reserves (in months of imports) | 3.3 | 3.5 | 4.0 | 3.8 | 4.6 |

Source: IMF Country Report No. 06/371, October 2006

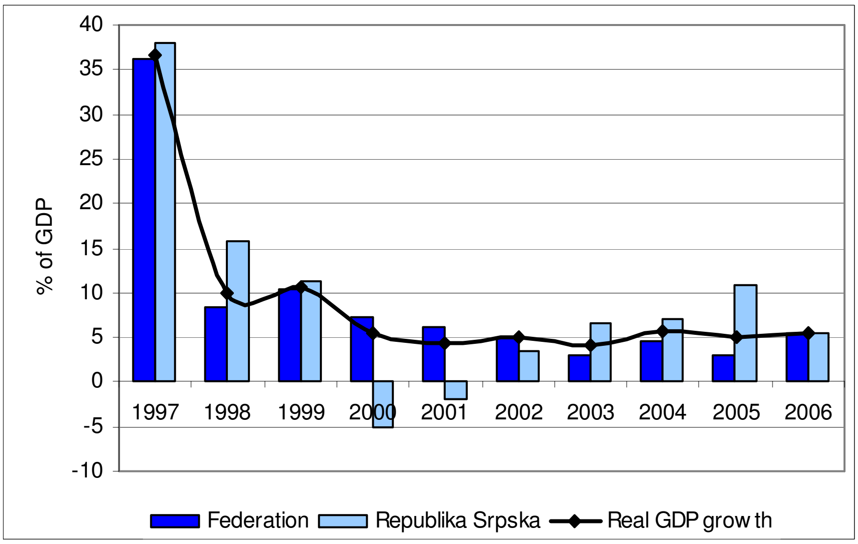
*Assuming 17% of GDP of debt to settle domestic claims against the Government.

## 4.3.2 Macroeconomic developments

*Macro economy*

During 1996-2000, GDP growth rates were on average above 22%. They fell to an average of 5% in the period 2002-2006. Despite high growth rates, nominal GDP in 2005 was still substantially below pre-war levels. There were significant differences between the Entities to 2005: the RS recorded a recession in 2000-2001 after which growth rates increased, whereas in the FBiH growth rates weakened (see Figure 4.1).

**Figure 4.1** **Real GDP growth in the State and Entities**




Source: International Monetary Fund

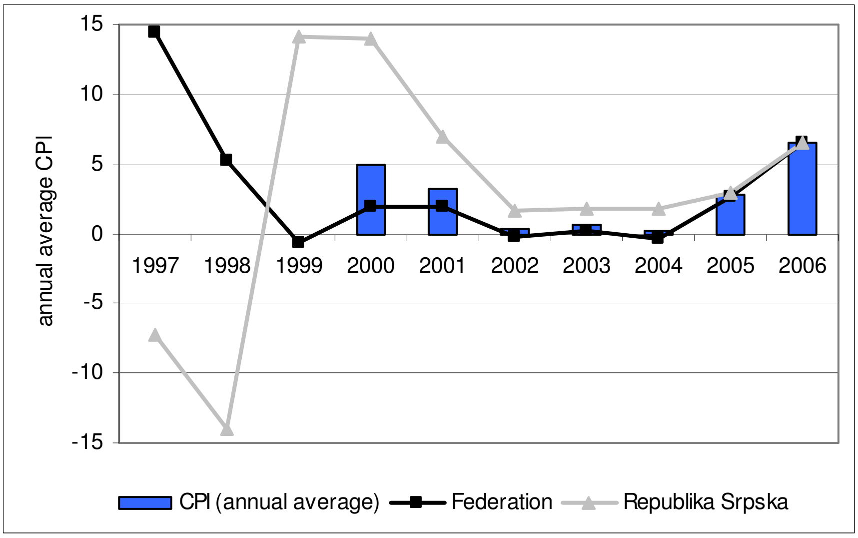
However, in line with the most recently available IMF projections, the differences in the growth rates seem to diminish in 2006.

Economic growth was driven by post-conflict reconstruction financed with the inflow of foreign assistance. Once these funds gradually diminished, growth weakened. A few large foreign investments in the aluminium and steel industries, which materialised during 2003-2004, influenced export and growth dynamics. The effects may be sustained as more foreign investment in the same industries will maintain continued increases in production. Moreover, high world prices of metals projected for the near future will reinforce this effect.

The official GDP statistics underestimate real developments. The Statistical Agency of Bosnia and Herzegovina (SABH) only recently adjusted GDP data for the unofficial economy. In July 2006, SABH made its first adjustment to account for imputed rents, which resulted in a (statistical) increase of GDP by 10%. The IMF has estimated that GDP could be 30-50% higher than official national accounts suggest.[8]

The Currency Board introduced in 1997 allowed for control of price increases, though significant differences remained across the Entities until very recently. Inflation growth in 2006 was mainly caused by the introduction of value-added tax (VAT) and administrative price increases.

**Figure 4.2 Annual average CPI in the State and Entities**




Source: International Monetary Fund

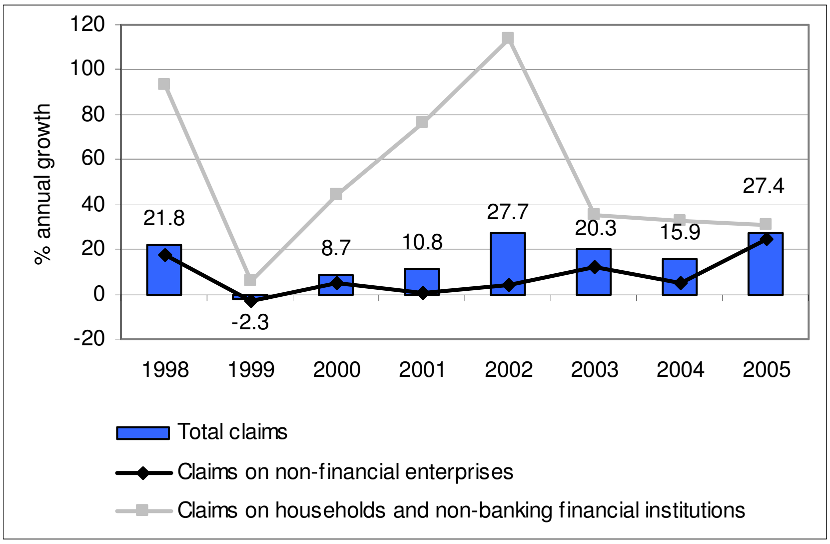
### *Balance of payments*

BiH's balance of payment situation has been characterised by high current account deficits above the level observed in other transition countries. The primary reason has been the large trade deficits of about 50% of GDP. Export potential has remained limited

[8] IMF Country Report No. 05/198. Recent GDP adjustment for imputed rents would decrease these numbers.

whereas imports have grown strongly, fuelled by wage growth and domestic credit expansion. Private sector credit grew at an average rate of 16% annually during 1998-2005, driven by increases in credit to households in 2000-2002 (see Figure 4.3).

**Figure 4.3 Growth in banking sector claims on enterprises and households**




Source: Central Bank of Bosnia and Herzegovina (CBBH)

In the same period, overall fiscal balance strengthened significantly, but bank credit growth offset any favourable impact of fiscal consolidation on the external deficit. Some interviewees claimed that there is limited room for further fiscal tightening, so adjustment of demand will have to come mainly from credit restraint. Others argued that demand restraint will have to come more heavily from even further fiscal consolidation.[9]

The banking sector is dominated by foreign capital with access to liquidity from abroad. In the framework of the Currency Board and an open capital account, available monetary policy instruments to restrain credit expansion are limited (see Box 4.2). In the Currency Board system, the Central Bank is not a 'lender of last resort', nor the 'Government's bank'. The major instrument to influence banking credit activity is reserve requirements, but this tool has limited effectiveness in an environment dominated by foreign-owned banks and could not be adjusted frequently. Available monetary policy instruments (such as reserve requirements, remuneration for banks' reserve accounts or other prudential ratios) have strong limitations under highly euroised money and credit creation. Therefore, the burden of demand restraint would have to fall more heavily on fiscal policy.

[9] See for instance, Daniel Kanda, *Credit flows, fiscal policy, and the external deficit of Bosnia and Herzegovina*, IMF Working Paper WP/06/276, December 2006.

**Box 4.2 Currency Board arrangements in Bosnia and Herzegovina**

Bosnia and Herzegovina conducts monetary policy through a Currency Board arrangement adopted in 1997. The choice of a Currency Board had two main motivations:

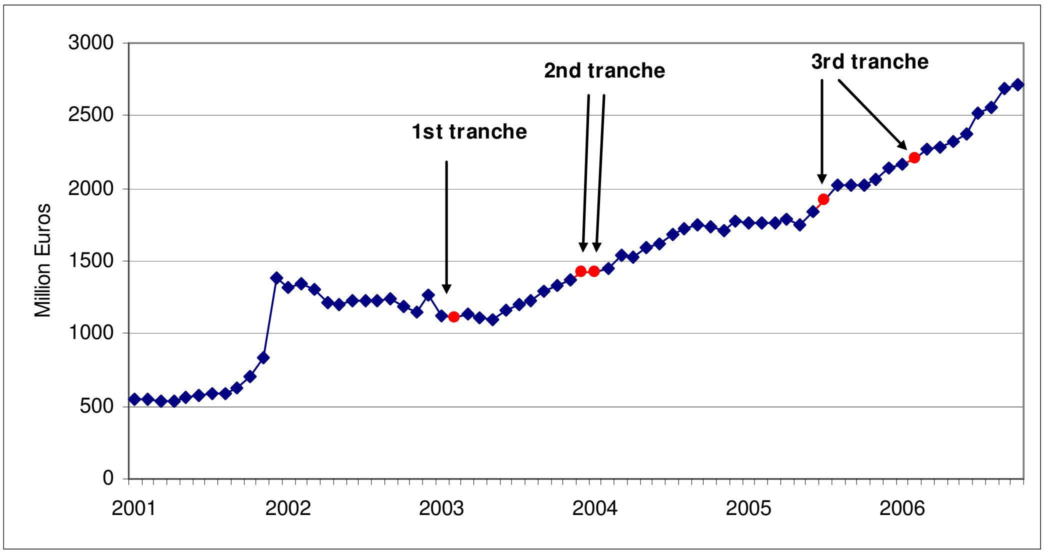
1. To provide a firm nominal anchor in the form of a fixed exchange rate to stabilise inflationary tendencies;
2. To establish a rule-based approach to monetary policy that considered the difficulties of establishing state institutions and making political decisions in the complex political environment existing in BiH after the war.

The Currency Board has proved successful. The BAM (Convertible Mark) has been a stable currency since it was introduced. Inflation is low and stable, and is (almost) similar in both Entities. Central Bank reserves have risen steadily. Moreover, use of the BAM has risen rapidly within BiH and it is now the dominant currency in all parts of the country. The local currency is fully backed by hard currency (Euros) or gold.

Current account deficits have mostly been financed by non-debt-creating flows such as donor support, resulting in falling ratios of external debt to GDP. However, large errors and omissions indicate significant measurement errors in the current and/or capital account.

Many factors have contributed to the rise in official reserves over the past few years, including permanent donor support (though with diminishing inflows), an increase in the reserve requirements of banks (resulting in more foreign capital inflows from foreign owners, as banks increased their external debt with their mother-banks abroad) and sustained inflows of remittances. All these factors allowed gross official reserves to increase from 3.3 months of imports in 2002 to a projected 4.6 months in 2006 (see Figure 4.4).

**Figure 4.4 Gross reserves of the Central Bank (million Euros) and tranches of the MFA**




Source: CBBH

*Public finances*

The Dayton Peace Agreement granted each Entity government with substantial autonomy, leaving no single body in charge of national fiscal policy. Responsibility for fiscal policy formulation was allocated between government institutions of the different Entities and international partners. There was no institution to target and monitor consolidated fiscal balance. To provide consistent fiscal policy at state level, close collaboration was necessary. Some progress has been achieved in this respect.

First of all, competence for indirect taxation has been shifted from entity to state level. This process comprised a number of steps: establishing the Indirect Tax Authority (December 2003), moving the Entities' customs administration under the authority of the ITA, implementing a new state-level sales tax and excise tax from January 1 2005, collecting taxes in the Single Account, and introducing VAT from January 1 2006 to replace the sales tax. At present, a state-level institution collects VAT, excise taxes and customs duties without the existence of similar institutions at entity level.

Secondly, the mandate for fiscal policy formulation has increased. In May 2005, the National Fiscal Council (NFC) was established as an informal body of economic policy-makers with the task of adopting annually a rolling three-year fiscal framework with aggregate targets for the consolidated budget and for all state and entity budgets. Unfortunately, without a legal mandate its effectiveness has been limited so far. A draft NFC Law has been prepared. If adopted it would be a major step towards improved fiscal policy coordination.

Thirdly, a recent improvement has been that, for the first time, the 2006 budgets were prepared without interventions by the Office of the High Representative. Also, the authorities themselves have made economic and fiscal projections, whereas before 2006 they relied on IMF projections.

Despite these achievements, there are areas of fiscal policy where further coordination is necessary. For example, the Entities have different social safety net and pension systems, and direct taxes are not harmonised. At present, the BiH authorities are not prepared to deal with these challenges. Recently, some coordination has been observed in direct taxation. The RS has adopted a new law on personal and corporate income taxation which is being implemented from January 2007, and similar changes have been prepared in the FBiH. However, the initial proposal has been revised in Parliament. If approved, it will not result in further direct tax harmonisation between the two Entities.

IMF statistics on general government finance indicate a significant reduction of public expenditure from 64.5% of GDP in 2000 to 50.2% in 2005 (see Table 4.7). In 2006, this declining trend was reversed as the figure increased to 50.6%. Public revenues increased to 55.4% of GDP in 2000 because of grants provided for budget support and investments. Despite these inflows, the budget still recorded high imbalances. The high dependence on foreign funds resulted in a downward fiscal adjustment when foreign inflows reduced. In 2005, a fiscal surplus was recorded. Recent estimates for 2006 suggest an even better performance, especially as actual collection of VAT revenues appears to be much higher than initially planned.

**Table 4.7 General government budget as % of GDP**

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 Estimated | 2006 Projected |
|---|---|---|---|---|---|---|---|
| Revenue | 55.4 | 53.8 | 46.0 | 50.3 | 50 | 51.1 | 51.3 |
| *Of which grants* | *11.3* | *11.1* | *7.2* | *6.3* | *5.5* | *4.8* | *4.3* |
| Expenditure | 64.5 | 58.8 | 49.3 | 52.4 | 50.4 | 50.2 | 50.6 |
| **Balance** | **-9.0** | **-4.9** | **-3.3** | **-2.1** | **-0.4** | **0.9** | **0.7** |
| **Primary balance** | **n.a.** | **n.a.** | **-2.1** | **-1.2** | **0.2** | **1.5** | **1.4** |

Source: IMF Country Reports No. 06/371 and No. 05/199

General government revenues are shared among the different levels (see Table 4.8). The state budget's share is limited, comprising only about 4.7% of general government revenues and grants in 2005. The introduction of VAT will increase revenues collected at state level, but their size will remain limited. The majority of public revenues are collected at or assigned to the cantons, federation municipalities and extra-budgetary funds.

**Table 4.8 Revenues and grants of different general government levels as % of GDP**

| | 2004 | 2005 estimates |
|---|---|---|
| Federation budget | 7.2 | 7.1 |
| Federation road fund | 0.6 | 0.7 |
| Cantonal and municipal budgets | 11.7 | 11.4 |
| Federation extra-budgetary funds | 10.2 | 10.2 |
| RS budget and municipalities | 8.8 | 9.2 |
| RS road fund | 0.4 | 0.5 |
| RS extra-budgetary funds | 4.5 | 4.8 |
| State | 1.6 | 2.4 |
| Indirect Tax Authority | - | 0.4 |
| Foreign-financed investment projects | 5.3 | 4.5 |
| **Total** | **50.3** | **51.2** |
| **Total general government *** | **50.0** | **51.1** |

Source: IMF Country Report No. 06/371

* Consolidated; cross-entity flows are netted out.

### *Quality of data*

The quality of data illustrating macroeconomic developments is poor. The National Bank of Bosnia and Herzegovina was created in 1997 and the Statistical Agency of Bosnia and Herzegovina in 1998. The IMF introduced BiH into International Financial Statistics only in July 2001. Therefore, data before that time are incomplete. Moreover, data are compiled mostly at entity level. Only recently did the National Bank take the lead in producing general government statistics at national level.

Moreover, the data could be inaccurate. For instance, the IMF argues that the current account deficit would be much lower if adjusted for measurement weaknesses. Therefore, official figures should be regarded with caution and strong conclusions cannot be based on these data. This has important consequences for modelling counterfactual scenarios and explains our cautious approach towards a quantitative approach, such that we also used a qualitative approach (the Delphi method) as explained in Chapter 2.

## 4.4 Counterfactual

Table 4.9 summarises the evaluation questions dealing with the analysis of possible counterfactual scenarios regarding macroeconomic stabilisation and structural reforms. This section presents the analysis of the Delphi questionnaires, focusing on macro-related findings. It also describes the economic modelling of the most likely counterfactual scenario.

**Table 4.9 Relevant evaluation questions for possible counterfactual scenarios**

| | Counterfactual |
|---|---|
| Q0.1 | What arrangements would have been implemented if the MFA had not been granted? |
| Q0.2 | What are the structural and macroeconomic effects of the most likely implementation scenario(s)? |
| | |

### 4.4.1 Most likely counterfactual implementation scenario

*Q 0.1: What arrangement would have been implemented if the MFA had not been granted?*

*Possible alternative arrangements*
Table 4.10 summarises the answers to the counterfactual question asked according to the Delphi method (described in Chapter 2). The analysis of responses showed some areas of consensus but required substantial interpretation effort, also in light of the comments elicited during the first and second rounds of interviews.

The respondents included two sub-sets – IFI and international organisation staff (reported in Table 4.11) and local views – whose perceptions were driven by different factors. IFI staff were aware of the balance of payment nature of MFA and were supposedly very familiar with legal and procedural constraints affecting the behaviour of IFIs, as well as of the EU. The local views reflected more closely the political instincts in BiH and tended to be inadequately familiar with the constraints mentioned above. Therefore, these views gave an idea of what the country would have tried to do or would have expected to see happening, rather than necessarily a considered assessment of what would have happened. Most importantly, these local views were based on the overarching perception of MFA not as a balance of payment instrument, but rather as a way to support structural reforms through budgetary assistance. It is worth noting that scarcely any of the interviewees in BiH referred to MFA as a macro-stabilisation instrument. In almost all cases at all levels, the emphasis was put on MFA as an incentive to spur economic reform.

A further element to be considered is possible disagreement on expectations and anticipated scenario at that time. The IMF SBA and consequently the MFA were conceived based on IMF macro-estimates that subsequently proved to be far from the reality. In particular, a fiscal surplus was registered for several years rather than the anticipated deficit. Again, a difference can be noted between those who were knowledgeable about the IMF forecasts and therefore able to build the counterfactual scenario, and those who did not agree with these projections in the first instance or tended to assess the counterfactual based on the actual situation in the following years, which proved much better than anticipated.

**Table 4.10 Imagine you are in 2002 and consider the situation as it was at that time. What would have happened if the MFA *had not existed* (all responses)?**

| | Very unlikely | Unlikely | Likely | Very likely | Don't know |
|---|---|---|---|---|---|
| **IMF** | | | | | |
| Larger programmes | 3 | 4 | 5 | 1 | 1 |
| Tighter policy conditions | 2 | 4 | 4 | 1 | 2 |
| Laxer policy conditions | 6 | 4 | 1 | - | 3 |
| No reaction | 4 | 3 | 3 | 1 | 3 |
| **EU** | | | | | |
| Switch money from technical assistance (TA) | 1 | 3 | 4 | 1 | **5** |
| No reaction | 2 | 2 | 1 | | **9** |
| **World Bank** | | | | | |
| Increase structural lending | | 5 | 7 | 1 | 1 |
| Tighter policy conditions | 2 | 6 | 4 | | 2 |
| Laxer policy conditions | 4 | 6 | 1 | | 3 |
| No reaction | 1 | 1 | 3 | | **9** |
| **Other donors** | | | | | |
| Increase lending | 1 | 4 | 3 | 1 | **5** |
| Switch money from TA | 2 | 5 | 2 | | **5** |
| More debt cancellation | 3 | 2 | | | **9** |
| **Bosnian Government** | | | | | |
| More taxes | 2 | 7 | 2 | 1 | 2 |
| Less public spending | 3 | 2 | 7 | 1 | 1 |
| More borrowing | | 1 | 8 | 3 | 2 |
| No reaction | 5 | | | 2 | **7** |
| | | | | | |

**Table 4.10** **Imagine you are in 2002 and consider the situation as it was at that time. What would have happened if the MFA *had not existed* (responses from staff of international organisations)?**

| | Very unlikely | Unlikely | Likely | Very Likely | Don't know |
|---|---|---|---|---|---|
| **IMF** | | | | | |
| Larger programmes | 2 | 1 | | 1 | |
| Tighter policy conditions | 1 | 3 | | | |
| Laxer policy conditions | 3 | | 1 | | |
| No reaction | 1 | | 2 | | 1 |
| **EU** | | | | | |
| Switch money from TA | | 1 | 1 | 1 | **1** |
| No reaction | | 1 | | | **3** |
| **World Bank** | | | | | |
| Increase structural lending | | 3 | 1 | | |
| Tighter policy conditions | 1 | 3 | | | |
| Laxer policy conditions | 2 | 2 | | | |
| No reaction | | | 2 | | **2** |
| **Other donors** | | | | | |
| Increase lending | | 2 | | | **2** |
| Switch money from TA | 1 | 1 | | | **2** |
| More debt cancellation | 2 | 1 | | | **1** |
| **Bosnian Government** | | | | | |
| More taxes | 1 | 3 | | | |
| Less public spending | 2 | 1 | 1 | | |
| More borrowing | 1 | 1 | 2 | | |
| No reaction | 1 | | | 1 | **2** |
| | | | | | |

Respondents had conflicting views on the likely alternative IFI arrangements. The commonplace solution was that, since MFA is a burden-sharing arrangement between the IMF and the EU stemming from an IMF estimate of a financing gap in a given country, the obvious alternative arrangement would have been increased IMF lending. However, it is interesting to see how a slight majority of respondents – including international respondents, and IMF staff among them – believed there was a upper-limit to IMF exposure in BiH almost irrespective of any financing gap estimates, so that increased financing would have been unlikely. All in all there was consensus that IMF conditions would have remained the same, though a large share of those who deemed greater IMF involvement logical tended to consider tighter policy conditions as likely.

As far as the EU was concerned, alternative arrangements included pressure to switch resources away from technical assistance to budgetary support. This was the result of two different arguments. Some respondents (international staff among them) thought that if *the worst had really come to the worst* and BiH had really faced a financial crisis, the EU would have been under very strong political pressure to provide macroeconomic support in any case through an emergency instrument *de facto* replicating MFA and presumably drawing resources from the TA budget. In other words, the Community Assistance for

Reconstruction, Development and Stabilisation (CARDS) legal regulation not allowing any form of macro-assistance at that time was deemed irrelevant. This was because it was widely believed that the EU would have had to find a political solution irrespective of the procedures in force. From another point of view, BiH respondents put the emphasis on the fact that requests for structural reforms would have further increased the already strong demand for switching resources away from TA into budgetary support.

The likely behaviour of the World Bank was also assessed controversially. Those respondents who focused on the emergency nature of MFA rightly noticed how an increase in World Bank structural lending would have been extremely unlikely. World Bank programmes have long preparation periods and certainly do not have the degree of flexibility needed to cope with a financial crisis and act as a substitute for MFA. Moreover, financing gap estimates are usually made after World Bank programmes have been agreed. However, since the large majority of respondents in BiH considered MFA first and foremost as a structural reform instrument, it was of little surprise that the World Bank was deemed the most likely alternative supplier of structural financing in the medium run. The vast majority of respondents did not think that turning the BiH into a high-lending scenario would have had major consequences in terms of conditions attached.

There was wide consensus that other donors' financial arrangements could not really be substituted for MFA.

Finally, the alternative arrangements available to the BiH Governments were assessed differently by international community staff and local respondents. While there was overwhelming consensus that the BiH Governments would have avoided any increase in fiscal pressure, opinions differed widely regarding the likelihood of budgetary cuts. While external observers were generally sceptical about BiH willingness to cut expenditure and more inclined to believe that a passive 'wait-and-see' attitude would have been adopted, local respondents considered tighter expenditure more likely. It was also commonly agreed that the Entities Governments would have tried to have recourse to increased external borrowing. However, the country had little access to private capital markets. The Government borrowed mainly from public creditors, and the only option for private borrowing would have been restructured debt to the London Club. Thus, additional private borrowing was not an option.

*Most likely counterfactual scenario*

In identifying the most likely counterfactual scenario, we based our analysis on actual developments rather than the original forecasts. In other words, the most likely alternative arrangements were identified based on the fact that real economic developments in BiH proved much better than originally forecast. This probably became apparent to BiH government officials monitoring their treasury accounts just a few months after the agreement was signed.

Based on this, and on the Delphi responses, the most likely counterfactual implementation scenario appears to be the following:
- no additional IMF financing;

- no real reason to exert strong pressure on the EU to provide macro support through TA money;
- no increased World Bank structural lending;
- no additional involvement of the donor community;
- no additional borrowing from private capital markets.

This scenario has the following implications for the original IMF programme. If the residual financing gap had not been financed by MFA, the IMF would have revised its programme in cooperation with the BiH authorities before seeking approval from the IMF Board. The quantitative performance criteria in the Stand-by Arrangement would have been more austere to enable the country to restore macroeconomic stability. Adjustments would have been made to the macroeconomic framework and the conditions to achieve the targets set in the macro framework. These changes would have referred to tighter fiscal policy and lower accumulation of international reserves.[10]

The adjustments would have differed in timing. In 2003-2004, the Government would have cut public expenditure to prevent higher fiscal deficit. In 2005-2006, the Government would not have made any adjustments as a surplus was recorded. The lack of MFA financing would just have resulted in a decrease in the surplus.

The Central Bank would have maintained the Currency Board arrangement, which does not allow for government financing. The decrease of foreign reserves would have led to a decrease of money in circulation.

As indicated earlier, a notable characteristic of the MFA to BiH was the division of tranches between the State and the Entities. It could be argued that the State, RS and FBiH would have reacted differently. This would inevitably have created (additional) political tensions. It seems very likely that the state authorities would have had to pay the highest price in terms of budgetary cuts. These results are in line with opinions expressed during the interviews by those analysts who maintained that MFA in the short run avoided a tighter fiscal policy and budgetary costs, of which state institutions would have borne the main brunt.

The only readily available fiscal data for the Entities are not sufficiently informative. The data show public investments financed with foreign grants as an overall item, without distinguishing between the State and the two Entities (see Table 4.12).

[10] In terms of the quantitative performance criteria this would have meant a lower ceiling on gross credit by the banking system to the consolidated general government, and a lower ceiling on contracting or guaranteeing of new concessional external debt.

**Table 4.12** **Fiscal balances of general government (as % of GDP)**

| | 2003 | 2004 | 2005 est | 2006 proj | 2007 proj |
|---|---|---|---|---|---|
| Federation budget | 0.2 | 0.6 | 1.3 | 1.2 | 1.1 |
| Federation road fund | 0.0 | 0.0 | -0.1 | -0.4 | -0.4 |
| Cantonal and municipal budgets | 0.1 | 0.3 | -0.1 | -0.1 | -0.7 |
| Federation extra-budgetary funds | 0.1 | 0.4 | 0.2 | 0.4 | 0.4 |
| RS budget and municipalities | 0.4 | -0.1 | 0.7 | 0.7 | 0.0 |
| RS road fund | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 |
| RS extra-budgetary funds | 0.0 | 0.1 | 0.2 | 0.0 | 0.0 |
| State | -0.1 | 0.1 | 0.3 | -0.1 | -0.1 |
| Indirect Tax Authority | | | 0.4 | 0.6 | |
| Brčko district | -0.1 | 0.3 | -0.2 | -0.1 | -0.1 |
| Foreign-financed investment projects | -2.6 | -1.9 | -1.6 | -1.3 | -1.6 |
| | | | | | |

Source: IMF, Country Report No. 06/371

The counterfactual scenario only considers expenditure reduction at the level of general government. In practice, however, there is little general government fiscal policy. All decisions would be made at state and entity level, taking into account their specific fiscal policy developments.

A more drastic counterfactual scenario would have been a worse evolution of international trade and financial markets than actually anticipated and the resulting triggering of a real balance of payments crisis. This would have led the IMF to lend more, put the EU under strong pressure to provide budgetary support resources and probably driven the World Bank to reassess its financial assistance package. In this scenario any arrangements available to the BiH Governments would not have been enough to cope with the crisis. One-third of respondents indeed highlighted what would have been a radically different counterfactual arrangement in this scenario. They pointed out that in a catastrophic scenario the BiH Governments' pressure to abandon the Currency Board would have grown substantially.[11] At any rate, the peculiar BiH constitutional arrangements and the role played by the Office of the High Representative would have made this outcome unlikely. This more drastic counterfactual scenario is therefore not elaborated in the following sections.

### 4.4.2 Macroeconomic effects of the most likely implementation scenario

*Q0.2: What are the macroeconomic effects of the most likely implementation scenario(s)?*

As indicated in Chapter 2, an economic modelling approach was applied to quantify the macroeconomic effects of the most likely counterfactual implementation scenario.

As noted, the policy adjustment would have differed by tranche, but in general could be characterised as: (i) tighter fiscal policy; and (ii) lower accumulation of international

[11] Some analysts maintained that pressure on the Currency Board will increase if reforms in the real sector are not carried out.

reserves. It is assumed that the Government would have had to compensate with available policy instruments for lack of alternative financing.

In 2003, two MFA disbursements took place: the first tranche of € 15 million (grant) and the grant component of € 10 million of the second tranche. Lack of MFA grants would have influenced the budgets by decreasing available revenues. We have assumed that the Government would simply have limited expenditure by this amount, keeping the budget deficit unchanged. One may argue that the reaction at entity level may have differed, but available data did not allow for modelling these differences. There could have been some indirect effects. The share of grants dedicated to the state budget was planned to be partly spent on the Ministry of Foreign Affairs for funding its diplomatic representatives. In the counterfactual scenario lack of these funds could have delayed the process of improvements in diplomatic services.

In 2004, the loan component of the second tranche was disbursed. For the counterfactual scenario we have assumed that lack of these funds would have resulted in expenditure cuts at entity level. As a result, the general government deficit would have been lower. Contrary to the previous year, the expenditure cuts in 2004 would have been more difficult. Foreign grants were mostly used for public investments, and if not disbursed (as assumed for 2003) would just have resulted in a reduction of capital expenditure. By contrast, the absence of loans (the assumption for 2004) would have meant that some current expenditure (such as wages, transfers and government consumption) would have had to be reduced. This would have been a more politically sensitive issue.

In 2005, the third tranche of € 15 million of grants was disbursed. For the counterfactual scenario it is assumed that the absence of MFA grants would have meant lower public revenues. However, in 2005 the general government recorded a surplus. Therefore it is assumed that with lower revenues this surplus would have decreased and there would have been no need for expenditure reduction.

In 2006, the loan component of the third tranche of € 10 million was disbursed. In the counterfactual scenario the assumption is that public expenditure would not have been influenced as the general government budget recorded a surplus.

Indirect effects would have been determined by market reactions. As MFA was part of the overall financial package for BiH, lack of this assistance could have influenced other donors. For the purposes of modelling it is assumed that other donors' reactions would not have changed.

The absence of MFA would also have influenced the current account (because of the grant component) and capital account (because of the loan component). With the Currency Board in place, lower accumulation of reserves would have been fully reflected in lower money supply and subsequently through the money multiplier in lower growth of credit to the economy. Lower credit would have led to decrease in import demand. However, with the high liquidity of the banking sector it is assumed that the compensating reduction in imports would have been limited. Data limitations mean that the responsiveness of imports to credit in the economy cannot be credibly tested.

Therefore, we have assumed arbitrarily that the size of the effect would have been half of the size of the reduced inflow of gross reserves because of lack of MFA.

BiH is characterised by high imports, reaching 80% of GDP. Given the scale of MFA, the fall of imports caused by the lack of the MFA arrangement would have been limited.

To summarise, the absence of MFA would have led to expenditure reduction, lower import dynamics and lower credit to the private sector. All these factors would be expected to influence economic growth. The mechanism of this reaction is unidentified. The modelling approach has been limited because consistent data for all sectors are available only from 2000. Short time series make it unfeasible to test the effect of different GDP components on economic growth.

For the purposes of this modelling exercise, it has been assumed that GDP growth can be modelled in the same way as for the Former Yugoslav Republic of Macedonia, assuming a similar structure of the economy shaped by a common history. Applying this model to BiH, we have not been able to identify a significant influence on GDP growth. The lack of data and the difficulty of identifying a functional relationship between GDP components and the growth rate do not allow for the formulation of firm conclusions. The modelling exercise can only claim that it is not possible to prove that policy change in the counterfactual scenario would have led to a slowdown of economic growth.

Lack of MFA assistance would have resulted in lower debt accumulation. The loan component of € 20 million equals 0.2% of GDP. During the period of MFA, however, total public debt fell by 3.6% of GDP, so the MFA assistance had little influence on this trend.

Finally, it should be stressed that absence of MFA would not have posed threats to the exchange rate arrangement, since budgetary adjustments would have been made to reflect the lower revenues. In 2003-2005, the foreign reserves of the Central Bank increased steadily; lack of MFA assistance would have decreased the rate of this progress. It is difficult to imagine that lack of MFA would have changed market sentiments towards BiH and led to capital outflow. The presence of foreign capital is limited, and most of the inflows comprise donors’ funds; foreign direct investment (FDI) or portfolio investments comprise a much smaller proportion.

## 4.5 Net impact on macroeconomic stabilisation

*Q1.3: What has been the contribution of the grants and/or loans provided by the MFA operation to the achievement of MFA objectives?*

### 4.5.1 Delphi assessment

The Delphi assessment of the net macroeconomic impact of MFA, based on a counterfactual analysis, reflected respondents’ different appreciations of the role played by external macroeconomic assistance in the process and their different levels of familiarity with macroeconomic data. It is worth noting how opinions in this respect differed widely even among IFI experts and interviewees, ranging from (i) considering external macroeconomic assistance to have played a major role in the stabilisation process to (ii) assessing the bulk of readjustment as substantially depending on natural dynamics. Those holding the latter view, to reinforce their point, noticed how BiH could afford to leave most of the World Bank assistance undisbursed, without suffering major macroeconomic consequences.

In the Delphi analysis, IFI and international organisation staff attributed a greater role to external macro assistance in economic stabilisation than did the locals (see Table 4.13). The latter, in particular, emphasised the indirect role played through support for structural reforms rather than a direct stabilisation role. This also partly explains the different assessment given to the specific contribution of MFA (see Table 4.14)

**Table 4.13 What was the role played by external macroeconomic assistance in the period (IMF, EU MFA, WB structural loan, European Investment Bank (EIB)) in this stabilisation process, if any?**

| | Worsened things | No real role | Minor role | Substantial role | Don't know |
|---|---|---|---|---|---|
| All respondents | - | 1 | 4 | 9 | - |
| *Of which international respondents* | | | *1* | *3* | |
| | | | | | |

As Table 4.14 shows, while MFA was attributed an overall figure of 18% of the total contribution of macroeconomic assistance to the stabilisation process, this figure was slightly lower among local respondents than international experts. They tended to emphasise the role played by external macroeconomic assistance in general, so their assessment of MFA in relative terms within such assistance was slightly lower.

**Table 4.14 How do you assess the importance of EU MFA's contribution to the stabilisation process as compared to other institutions or means? (roughly in % weight terms)**

| | IFIs' views | Local views | TOTAL |
|---|---|---|---|
| Natural dynamics/natural evolution of economic conditions | 15% | 40% | 34% |
| External macroeconomic assistance overall, of which: | 85% | 60% | 66% |
| • *IMF* | *28%* | *21%* | *22%* |
| • *WB (structural adjustment loans)* | *18%* | *17%* | *17%* |
| • *MFA* | *20%* | *18%* | *18%* |
| • *Other (including tax rates) – specify* | *18%* | *6%* | *8%* |
| **TOTAL** | 100% | 100% | 100% |

Another notable difference between the two sub-groups was that local respondents emphasised the role of natural dynamics in the stabilisation process, and correspondingly reduced that played by macroeconomic assistance (see Table 4.14). They substantially downplayed the role of other sources, namely TA provided by various donors, which was partly used to cover government expenditure. As noted , BiH has been one of the largest per capita recipients of Official Development Assistance funds in the world.

Otherwise, there were some significant regularities in the patterns of responses. For instance, while disagreeing on the relative importance of external macroeconomic assistance, both groups agreed in giving the IMF around one-third of the overall merit and in deeming MFA a little more important than World Bank assistance.

All in all, however, with one exception the overall sample points towards a favourable appreciation of the present macroeconomic stability of the country compared with mid-2000 (see Table 4.15).

**Table 4.15 How do you assess the current overall macroeconomic stability of Bosnia in comparison with the situation in mid-2002?**

| Worsened | The same | A bit better | Much better | Don't know |
|---|---|---|---|---|
| 1 | | 8 | 4 | 1 |
| | | | | |

The rationale behind the one radically dissenting view (Table 4.15) can be summarised as follows. The respondent maintaining that the country's macroeconomic stability has worsened was not actually referring to macroeconomic stability as such, but rather to structural stability. The respondent built an argument according to which real growth is hindered by the Currency Board's suppressing real inflation and contributing to domestic unemployment. This would make the country's overall economy unsustainable in the long run. When the Currency Board mechanism no longer masks these imbalances, they will be: *'bound to traumatically explode the day the KM will be allowed to float'*. So if the price to be paid for macro stability is slow growth, limited competitiveness and reduced exports, then a little macro instability would be a much more preferable option.

Different appreciations of the temporary path of macroeconomic stabilisation substantially qualified the above answers to the Delphi questionnaire. Quite predictably, respondents had great difficulty in assigning a realistic subjective probability to the risk of a financial crisis in the country for the years 2002-2006. Local respondents were certainly less at ease with this exercise than others, as the magnitude of variation in their subjective assessment shows (see Table 4.16). The overall perception of the underlying paths was far from homogeneous.

**Table 4.16 What is the likelihood (in terms of rough % chance) of a financial crisis you have attached to BiH in the following years?** (eight responses obtained)

| 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| **Local respondents** | | | | |
| 50% | 50% | 50% | 60% | 70% |
| 50% | 50% | 50% | 30% | 20% |
| 40% | 35% | 30% | 40% | 25% |
| 20% | 30% | 40% | 20% | 20% |
| **International respondents** | | | | |
| 10% | 5% | 0% | 0% | 0% |
| 10% | 5% | 5% | 10% | 15% |
| 30% | 30% | 60% | 60% | 40% |
| 20% | 20% | 15% | 15% | 15% |
| | | | | |

In particular, some respondents (including IFI experts) seem to have perceived a peak in the level of risk in 2004 or in the 2004-2005 period. In a number of cases, 'improvement' in the level of risk was perceived when compared with previous years and not with the beginning of the period. In two notable dissenting cases (one a well-informed international expert), the actual level of risk was perceived as having increased. The improvement reported generally in the 2005-2006 period was mainly attributed to fiscal policy reforms, particularly establishment of the ITA and the introduction of VAT.

Probably related to this point is that timing considerations on disbursement of the MFA (implicitly in the 2003-2004 period) were the most frequently mentioned area in which MFA could have been made more effective in BiH. This issue was deemed more relevant than that of a larger grant component (see Table 4.17).

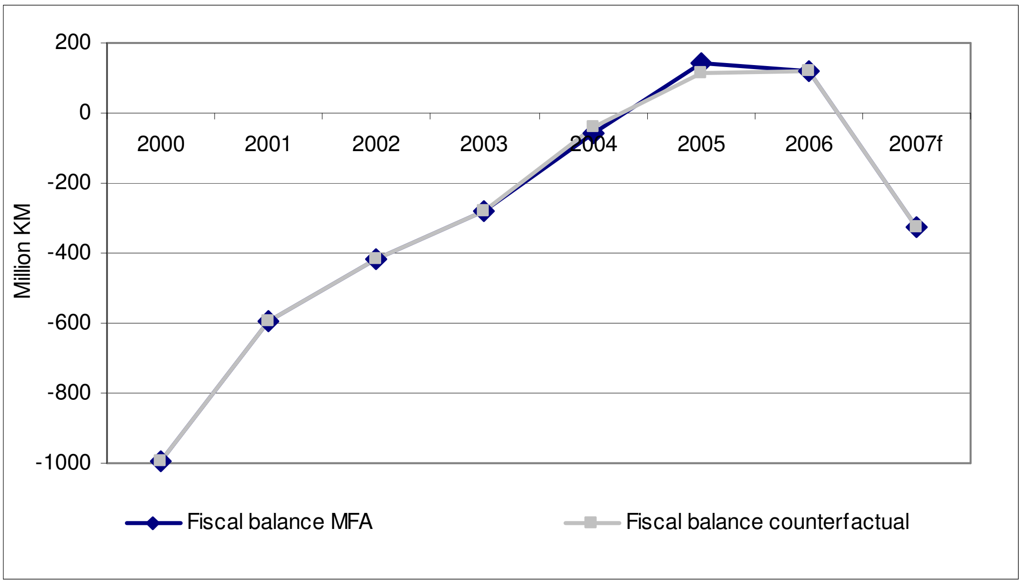
**Table 4.17 How could have the MFA role have been enhanced in BiH?**

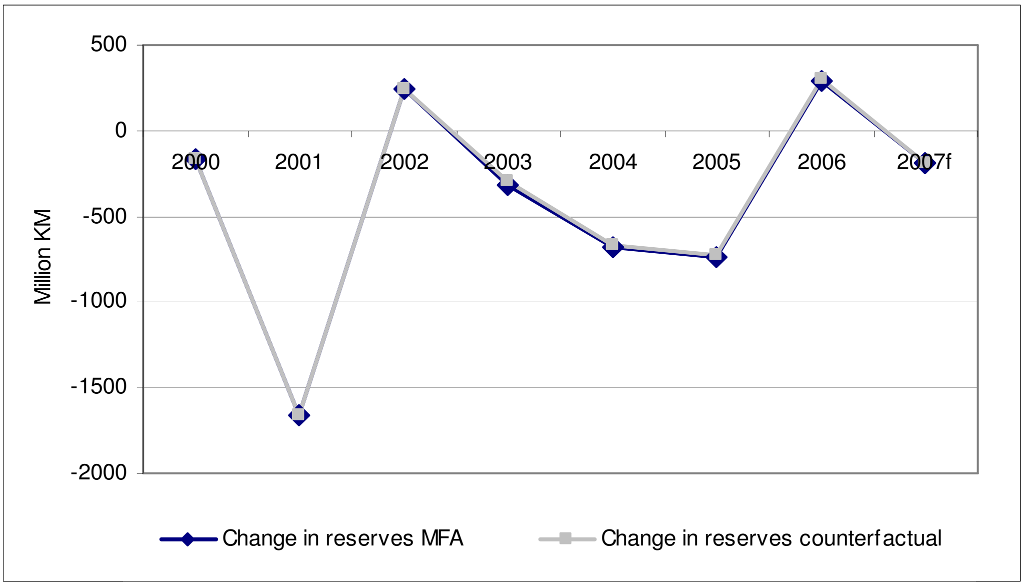
| | No way | Minor enhancement | Enhancement | Strong enhancement |
|---|---|---|---|---|
| More timely delivery | 2 | 2 | 4 | 4 |
| Larger grant | 3 | 1 | 5 | 3 |
| | | | | |

## 4.5.2 Modelling outcomes

In the modelling approach, the most likely counterfactual scenario assumes policy reversal in reaction to lack of MFA, resulting in budgetary policy adjustments, lower reserve accumulation and contraction in imports. Figure 4.5 summarises the impact of MFA on the fiscal balance and international reserve positions.

**Figure 4.5 Impact of MFA on fiscal balance and international reserve position (in millions KM)**






Given the data limitations, the only available modelling instrument is a consistency check for all economic sectors. Based on the data, we conclude that the direct effects of MFA assistance have not been large when measured against the main macroeconomic indicators such as fiscal balance, international reserves, imports and money supply. However, we cannot quantify the expected additional indirect and cumulative effects.

Assuming a growth function similar to the Former Yugoslav Republic of Macedonia, we could not identify any substantial influence on growth or inflation. This does not demonstrate a lack of such effects, but indicates the problems with current macroeconomic data not allowing for a more detailed modelling approach.

Although not proved by the numbers, MFA has undoubtedly had positive effects on the economy, shaping the perceptions of policy-makers and other market players and influencing the perceptions of risk in the country.

### 4.5.3 Conclusions

According to the Delphi sample of respondents, the net macroeconomic impact of MFA can be seen as having supported an overall improvement in macroeconomic stability over the whole period of the operation, when natural dynamics and external support acted in synergy in relieving the situation. The magnitude of MFA's net impact can be considered as non-negligible. If subjective estimates are to be believed, it can be roughly concluded that the MFA instrument contributed to some 18-20% of the overall stabilisation effect.

However, according to respondents a small part of this stabilisation effect was also achieved indirectly through qualitative means. In particular, MFA appeared to be perceived as an instrument that has helped to coordinate policy-making between the two Entities and fostered policy dialogue. However, and most importantly, a substantial part of the macroeconomic improvements were attributed to the effects of the structural reforms and in particular to the reform of indirect tax policy.

## 4.6 Indirect macroeconomic effects of structural conditionality

*Q3.1: What, if any, has been the contribution of actions resulting from the respect of structural conditionality criteria to the achievement of the short and medium-term macroeconomic objectives of the assistance (i.e. the indirect effects of structural conditionality criteria)?*

The most visible effect of structural conditionality has been in the area of indirect tax and customs reforms, which have led to an increase in indirect tax revenues and have thus contributed to a fiscal (primary) surplus. Recent estimates for 2006 show an enormous increase in tax revenues – even higher than initially estimated – mainly because of the successful introduction of VAT, which was significantly supported by the EU.

Another indirect macroeconomic effect has been in the country's risk rating. Since March 2004, BiH has been rated by Moody's Investors Service. Its first rating was B3 (with a positive outlook). The country was therefore ranked at the lowest level of so-called medium-risk debtors. In May 2006, Moody's upgraded the ranking of BiH to B2 status (with stable outlook), among other reasons because of the introduction of VAT as of January 2006. Therefore, fulfilment of a structural condition can be deemed to have had a notable macroeconomic effect to the extent that risk ratings are deemed to positively influence the attraction of FDI and improve external credit conditions.

## 4.7 Unexpected macroeconomic results

*Q3.2: Has the assistance given rise to any unexpected short and medium-term macroeconomic effects? What were they and how did they occur?*

A major result in terms of awareness-raising was represented by the actual MFA monitoring process. As Chapter 8 notes, the MFA monitoring experienced difficulties in the early stage of the operation. In the event, the MFA reportedly represented one of the first instances when the BiH State Government had to consolidate data coming from the two Entities. That kind of cooperation in vertical reporting then paved the way for further initiatives in the field of data-sharing for fiscal reform. However, the policy consequences of this should not be overestimated, in terms of both quality of results achieved and innovation of action, as an ex post consolidation exercise had already been carried out by the Central Bank. But an awareness-raising effect was certainly achieved.

# 5 Impact on external sustainability

## 5.1 Introduction

Table 5.1 presents the evaluation questions for analysing the impact of MFA on external sustainability. It is followed by the evaluation findings.

**Table 5.1 Evaluation questions on the MFA's contribution to external sustainability**

| Q4 To what extent has the MFA contributed to returning the external financial situation of the recipient country to a sustainable path over the medium to longer term? | |
|---|---|
| Q4.1 | How did the external financial situation of the recipient country evolve prior to and during the MFA operation? |
| Q4.2 | What are the main internal and external factors on which the current trend in the country's external financial situation and its prolongation into the future are conditional? |
| Q4.3 | How is the country's external financial situation likely to evolve in the five years following the final disbursement, given the likelihood of changes to current conditions? |
| Q4.4 | What is the MFA contribution to medium and long-term external sustainability prospects? |
| | |

## 5.2 Gross impact – actual evolution of external sustainability indicators

*Q4.1: How did the external financial situation of the recipient country evolve prior to and during the MFA operation?*

During the war, BiH accumulated substantial arrears towards its creditors. External debt was unsustainable at the end of the war and was not being serviced. At the end of 1997, external public debt amounted to over 100% of GDP. To lower this debt burden, the Government negotiated debt rescheduling. In the course of the rescheduling process BiH managed to renew its membership of the IMF and the World Bank, providing the country with renewed access to borrowing. Agreement was subsequently reached with the Paris Club, which led to the reduction of BiH debt by 67%. In the context of the London Club, 73% of the country's commercial debt was written off in 1998. The settlement of relations with the majority of creditors was reflected in the debt stock. The write-off and rescheduling of debt also improved the debt-servicing situation. The concessional nature of the debt meant that debt-service payments were relatively low and declining. Expressed as a percentage of exports of goods and services, these payments decreased from 16% in 1997 to 7.7% in 2002.

Economic growth in the second half of the 1990s reflected a strong post-conflict recovery connected with high levels of imports and public investments. These developments were associated with substantial external and internal imbalances. Large current account and fiscal deficits were financed with international financial assistance, while foreign direct investments remained limited. The high level of remittances from BiH citizens living abroad reduced the country's borrowing needs. The grants received, major improvements in primary borrowing and the concessionary character of new borrowing in the rapidly growing economy resulted in a decrease of public external debt. When MFA was granted, public debt amounted to only 34.3% of GDP. The inflow of foreign financing allowed for a moderate recovery of gross international reserves from one month of prospective imports in 1998 to 3.3 months in 2002. MFA allowed for further foreign reserve accumulation to 3.8 months of imports in 2005.

During the MFA operation, public external debt declined further to some 30% of GDP in 2006 (see Table 5.2). The official amount of domestic public debt seems negligible, but there are significant domestic contingent liabilities. These obligations comprise liabilities from war damages, frozen foreign currency deposits and restitutions. Depending on the court ruling, this figure may add up to as much as 75% of GDP (see section 5.3).

**Table 5.2 Selected external indebtedness measures**

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 (est.) | 2006 (proj.) |
|---|---|---|---|---|---|---|---|---|---|---|
| Total public debt to GDP | n.a. | n.a. | n.a. | 41.9 | 40.1 | 34.8 | 30.6 | 28.1 | 31.7 | 48.2* |
| External public debt to GDP | 119 | 68.1 | 71.9 | 41.6 | 39.8 | 34.3 | 30.2 | 27.8 | 30.0 | 29.4 |
| Net present value (NPV) of external public debt | n.a. | n.a. | n.a. | 31.8 | 30.4 | 26.2 | 23.1 | 21.2 | 22.9 | 22.5 |
| External debt to GDP | n.a. | n.a. | n.a. | n.a. | n.a. | 56.5 | 55.3 | 53.5 | 57.9 | 54.7 |
| External debt to exports | n.a. | n.a. | n.a. | n.a. | n.a. | 214.9 | 197.1 | 165.7 | 159.4 | 147.8 |
| External debt service (% exports of goods and services) | 16 | 12 | 11.5 | 7.5 | 6.1 | 7.7 | 6.8 | 4.8 | 4.1 | 4.3 |

Sources: IMF Country Reports No. 06/371 (2002-2006), No. 05/199 (2000-2001), No. 02/52 (1997-1999)

*Assuming 17% of GDP to settle domestic claims against the Government.

New debts were extended by institutional creditors, whereas access to financial markets remained limited. The data on external public debt at the end of 2003 indicated that 94% comprised obligations towards multilateral creditors. It was expected that the high participation of foreign capital in the banking sector would lead to rapid growth in borrowing from abroad. However, to date this feature has not been observed. The share of private external debt has remained stable at the level of about 25% of GDP.

The external debt ratios presented in Table 5.2 should be considered together with some benchmarks. Indicative debt burden thresholds depend on a country's quality of policies and institutions, for instance, as measured by the Country Policy and Institutional Index (CPIA) of the World Bank.[12] The end-2005 index for BiH for debt policy was equal to 4,

[12] World Bank, *How to do a debt sustainability analysis for low-income countries*, October 2006.

which is above the threshold indicating strong policy (CPIA≥3.9).[13] For a country conducting strong debt policy, the NPV of debt as a percentage of GDP should not exceed 60%, and debt servicing as a percentage of exports should not be higher than 35%. For BiH, these indicators are below these thresholds.

## 5.3 Identification of major risk factors

*Q4.2: What are the main internal and external factors on which the current trend in the country's external financial situation and its prolongation into the future are conditional?*

*Conditional liabilities*

The domestic claims against the Government will continue to hang like Damocles' sword over the country's public finances until the terms of settling all these claims are finalised in a legally sound and financially sustainable manner. The method of settling the liabilities might strongly influence debt amount and debt-servicing costs. It will also influence the size of primary budget surpluses required and thus indirectly fiscal policy.

These obligations comprise claims on the Government for war damages, frozen foreign exchange deposits of individuals, bank deposits seized during the war, expenditure arrears and privatisation coupons. Furthermore, the issues are compounded by restitution claims for property seized after the Second World War.

The Government has already made some decisions. In 2004, a law was approved to restructure these various liabilities into zero coupon bonds (up to 50 years) and cash payouts. This implied an NPV of 10% of GDP. The constitutional court rejected the terms of the domestic claims plan in the RS regarding war damages, and of that in the FBiH concerning foreign currency accounts. Therefore, a new approach had to be applied.

The Government decided again on the settlement of obligations for frozen foreign currency deposits (at state level), war damage claims (entity level) and general liabilities for wages and other arrears (RS). According to recent IMF estimates, these obligations would increase government debt by about 25% of 2005 GDP and would generate an average annual debt service of about 1% of GDP over the medium term. However, there are pressures to obtain more favourable terms. Recently, the Lower House of Parliament amended the law on frozen foreign currency deposits. If approved by the Upper House, the estimates of budgetary costs will need to be revised. Moreover, the terms of settling restitution claims are still unclear, and the size of these claims is potentially very large. A draft law is being prepared.

BiH also has claims on the basis of works executed before the war. Negotiations with Russia on the pre-war clearing debt are ongoing. Similar negotiations have to be initiated with other countries, including Iraq and Libya.

[13] http://www1.worldbank.org/operations/IRAI/ECA/bosniaHerzegovina.pdf and IMF and IDA, *Operational framework for debt sustainability assessments in low-income countries – further considerations*, 2005.

The more favourable scenarios imply higher risks for fiscal sustainability. In order to provide fiscal sustainability, higher primary budget surpluses will have to be achieved. Maintaining a surplus will be a challenge as fiscal coordination has proved difficult and the BiH Governments have started to show reform fatigue. Expenditure cuts would be necessary. This could contradict the plan to strengthen BiH, implying more public spending especially on institutional capacity building at state level. However, the World Bank in its recent Public Expenditure and Institutional Review identified potential savings in wages, administration expenses and transfer to households of up to 7 percentage points of GDP, so there appears to be room for manoeuvre for expenditure cuts.

*Macroeconomic risks*

There are also risks connected with macroeconomic policy: large current account deficits, limited sources of financing, fragility of the Currency Board system and variability of remittance flows. These risks might substantially change the sustainability projections.

One of the weaknesses of the BiH economy is high external imbalances caused by high household demand for imports and limited export capacity of the corporate sector. Household consumption is stimulated by credit from the banking sector and inflow of remittances from abroad. It is also influenced by wage growth. The instruments available to Government to control these variables are limited.

Control over the banking sector is limited and not unified. The activities of the banking sector are supervised by two entity-based agencies. This is a notable risk factor, as under the Currency Board system the stability of the exchange rate regime is conditional on banking sector performance. The Central Bank is not allowed to act as ‘lender of last resort’ in case of banking-sector difficulties.

A further major risk is related to weaknesses in the performance of the corporate sector. At present, export capacity is still limited and hard budget constraints are not in place. With proper structural policy, the Government may stimulate restructuring processes in enterprises. Without progress in the medium term, these external imbalances will not be sustainable.

Finally, macroeconomic risk is also connected with fiscal policy. Settlement of contingent obligations will create new liabilities for the budget. With limited financing possibilities this would imply strong fiscal adjustment on the expenditure side and achievement of high primary surpluses. It is not clear whether the Government will be able to conduct such adjustment and resist vested interests. For instance, the proposed law on war veterans is a concern for fiscal stability. If expenditure adjustment is not in place, then the Government may try to look for other financing sources. Since access to international financial markets is still limited, the Government may be tempted to further increase the tax burden. This would negatively influence the growth prospects of the whole economy and result in an increase of external debt against GDP.

External sustainability is essential to preserve the Currency Board arrangement. This monetary policy rule was introduced to provide financial discipline and deliver price stability, and has proved effective. However, international experience shows that certain conditions have to be met to make this mechanism sustainable. A crucial condition is fiscal discipline. Without Central Bank credit, the sources of budget deficit financing are limited. Domestic financing may lead to crowding out of credit to private businesses, whereas foreign financing may cause external debt problems. Given these financing constraints, the Government has to commit itself to a tight fiscal position over the medium term. Moreover, the commitment to the exchange rate peg must be considered to be durable, which requires wages and prices to be flexible and the labour market relatively free of distortions. Therefore, without external sustainability the current exchange rate mechanism will not be maintained in the medium term.

Structural and institutional weaknesses could lead to abandonment of the Currency Board regime in the medium term. The macroeconomic risks for BiH indicate that without further reforms the present foreign exchange regime might not be sustainable. Export capacity is limited and public investment expenditure is mainly financed with donors' funds. The fall in donor support has to be replaced by domestic revenues. Currency Board sustainability is also conditional on constraining spending pressures such as domestic debt claims.

## 5.4 Projections of external sustainability – baseline and sensitivity analysis

*Q4.3: How is the country's external financial situation likely to evolve in the five years following the final disbursement, given the likelihood of changes to current conditions?*

*Quantitative modelling approach*

This section provides a set of projections about future external sustainability (Q4.3), based on recent trends (Q4.1) and constructed around identified risk factors (Q4.2).

Formulation of forward-looking external sustainability projections requires a consistent macroeconomic model with a focus on balance of payment dynamics. Such projections can be produced using a quantitative model designed for short-term macroeconomic stabilisation analysis. To apply such a model to medium-term sustainability projections, assumptions have been made about the dynamics of various macroeconomic variables consistent with previously observed trends and publicly available forecasts. The basic equation used for projecting new external borrowing is the balance of payment identity:

$$\Delta D_t = (MGS_t - XGS_t - INC_t - CT_t) - (FDI_t + KT_t)$$

where $\Delta D_t$ is change in total external debt, $MGS_t$ ($XGS_t$) are imports (exports) of goods and services, $INC_t, CT_t, KT_t$ denote net incomes, net current and net capital transfers from abroad and $FDI_t$ net inflow of foreign direct investments.

It is important to note that while assumptions have been made with due care, the results should be viewed as illustrative simulations rather than forecasts of actual developments.

*Findings*

For an assessment of the external financial situation of BiH over the next five years (starting from February 2006 when the last tranche of MFA was disbursed), IMF sustainability projections have been used as a basis. The latest projections are presented in two recent IMF country reports published in October 2006.

The baseline scenario assumes continued strong growth and low inflation, access to concessional borrowing with an average grant element of 35%, domestic borrowing on commercial terms and privatisation receipts of 2% of GDP in 2006 and 2007 from the sale of RS Telecom. In addition, it is assumed that conditional liabilities will increase debt by 17% of GDP in 2006 or by 25% of GDP in total. Furthermore, because of recognition of additional domestic claims, debt will grow by 10% of GDP in 2007 and by 5% of GDP in 2008. The projections show external sustainability indicators improving over the medium term (see Table 5.3). The baseline scenario reflects an optimistic situation of accelerated growth and reduced current account imbalances.

**Table 5.3 Debt sustainability projections, baseline scenario**

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| External debt to GDP | 54.7 | 54.2 | 53.5 | 52.5 | 52.5 | 52.1 |
| External debt to exports | 147.8 | 143.9 | 130.7 | 125.8 | 133.7 | 136.3 |
| Gross financing needs* as percentage of GDP | 42.6 | 41.1 | 39.2 | 39.5 | 42.3 | 43.3 |
| | | | | | | |

Source: IMF Country Report No. 06/371, 2006

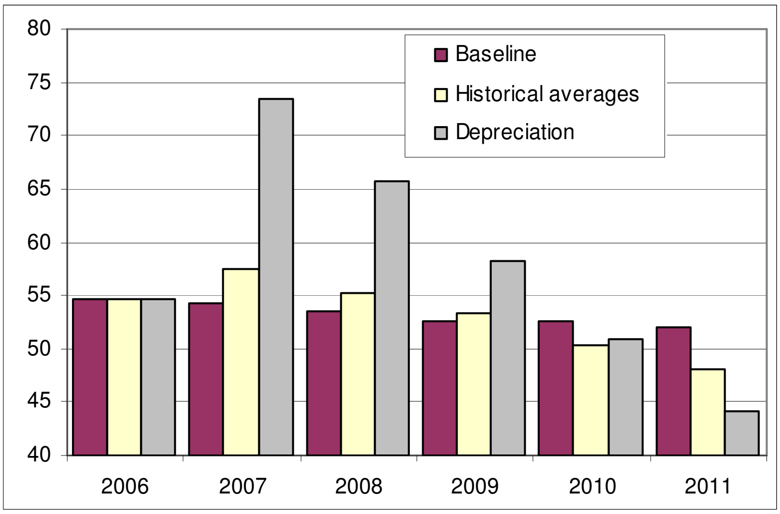
*Defined as public sector deficit, plus amortisation of medium and long-term public sector debt, plus short-term debt at end of previous period.

If historical averages are applied to key variables (real GDP, nominal interest rate, dollar deflator growth, non-interest current account and non-debt inflows as a percentage of GDP), external debt would remain high but would still show a declining trend.

The robustness of these results was tested by applying different macroeconomic shocks. Lower growth or higher interest rates could slow down the external debt dynamics. A shock of real depreciation of 30% in 2006 would result in a substantial increase in debt stock, but it would decrease in the medium term. The highest risk would be related to a current account shock, which could reverse the trend of external debt reduction and show an exploding trajectory. In the absence of such adverse shock, external debt will decline over the period analysed.

These scenarios may be overoptimistic as they assume continued access to concessional borrowing. Borrowing on market terms would imply approaching the net present value of the debt to its market value, and debt dynamics would become explosive. Fiscal primary surpluses are necessary to keep the ratio of debt to GDP on a declining trajectory over the longer term.

**Figure 5.1** **External debt as a percentage of GDP in different scenarios of debt sustainability analysis**




Source: IMF Country Report No. 06/371, 2006

## 5.5 MFA contribution to external sustainability prospects in the medium to long term

*Q.4.4 What is the MFA contribution to medium and long term external sustainability prospects?*

MFA influenced external sustainability with its direct impact on debt figures. As the bulk of the assistance comprised grants, in total MFA increased the debt figure by only 0.2% of GDP. The low proportion of the loan component with market interest rates limited future debt-servicing costs.

Based on the macroeconomic impact assessment, structural reform impact assessment and external sustainability analysis, we have identified the channels through which MFA has influenced prospects for external sustainability over the medium to long term.

The primary impact has been via macroeconomic stability, specifically through impact on economic growth. However, as explained in the macroeconomic analysis, based on the available data we have not been able to measure quantitatively any substantial impact of MFA on economic growth. But the Delphi analysis showed that respondents assigned a favourable macroeconomic stabilisation role for MFA (around 18% of all international community assistance).

The growth prospects for the BiH economy are promising. The IMF is assuming an average annual growth rate till 2011 of 5.2%. The potential for growth is increased by the 'reconstruction effect' as the economy is still recovering towards the pre-war level of development. A high inflow of remittances so far is a stable external financing source which may stimulate investments and support consumption levels. If MFA is seen as a component of the financial support provided to the BiH economy, which has influenced expectations concerning macroeconomic stability, then the expected growth is the result of external financial support provided to the country.

Another channel is institution building with structural conditionality. The overall package of structural conditions influenced macroeconomic reforms by changing the institutions of the country. The structural component increased the country's growth capacity for the future by accelerating privatisation and institution-building processes. Creation of the treasury system and adjustments in customs and tax administration, along with improvements in statistics, allowed for further reforms such as the introduction of VAT in 2006. Favourable VAT collection, along with expected further reforms on direct taxes, will lead to less dependence on foreign grants. MFA has contributed to these further reforms. Without stable revenues, the Government would have to cut expenditure (as assumed in the counterfactual scenario) or could be tempted to look for other financing sources. Given the limited access to international financial markets and underdeveloped domestic debt market, even if successful this could be very costly.

The composition of the MFA has had an impact on long-term sustainability. As the majority of the support comprised the grant component, MFA did not contribute to external debt accumulation and indirectly limited future debt-servicing costs. The mixed composition of grants and loans made MFA a concessionary borrowing instrument. This meant that the necessary reforms were conducted without additional pressure on the country's debt level.

The effectiveness of the assistance in terms of providing external sustainability in the medium and long term can be evaluated based on the effect on growth, exports and public revenues. The impact on growth and exports has been mainly indirect through the provision of macroeconomic stability and stimulating structural reforms. The impact on the capacity for creating public revenue has been more explicit. Indirect tax reforms stimulated by the package of external assistance have led to the creation of stable and potentially more sustainable budget revenue sources. The budget surpluses recorded in 2005 and 2006 mean that public consumption was preserved while significant reforms were conducted, such as simplification and harmonisation of the taxation systems. Balanced budgets with potential privatisation receipts provide the conditions to solve the problem of conditional liabilities in the future without damaging macroeconomic stability.

MFA was part of the overall financial package. It was also part of the EU stabilisation and association agenda and should be perceived in the context of common financial support to the country. As part of the financial package, MFA had a substantial political reinforcing effect on the credibility of the overall support for reform. The access to concessionary financing allowed the authorities to decrease indebtedness by restructuring and paying off existing debt and conducting necessary reforms, creating the basis for long-term growth. Thus the primary channel through which MFA acted appears to be the reinforcement of structural reforms and improved overall macroeconomic management. This indirect impact of MFA on long-term economic growth is the most important consequence of the assistance in supporting long-term external sustainability.

# 6 Impact on structural reforms

## 6.1 Introduction

Table 6.1 presents the evaluation questions for analysing the impact of MFA on structural reforms. The sections of this chapter provide our analysis based on these evaluation questions.

**Table 6.1 Relevant evaluation questions for analysing the impact of structural reforms**

| | Impact of structural reforms |
|---|---|
| Q2.1 | What are the short and medium-term expected structural effects of the assistance (in the context of the recipient country's reform programme)? |
| Q2.2 | How relevant are the short and medium-term expected structural effects of the assistance to the needs of the recipient country? |
| Q2.3 | To what extent have the short and medium-term expected structural effects of the assistance (in the context of the recipient country's reform programme) occurred as envisaged? |
| Q2.4 | What has been the contribution of actions resulting from the respect of structural conditionality criteria to the occurrence of expected structural effects? |
| Q2.5 | To what extent have structural effects been enhanced, if at all, by complementarities between the MFA and other EU instruments? |
| Q3.2 | Has the assistance given rise to any unexpected short and medium-term structural effects? What were they and how did they occur? |
| | |

## 6.2 Structural objectives of the intervention

*Q2.1 What are the short and medium-term expected structural effects of the assistance (in the context of the recipient country's reform programme)?*

Disbursement of the second tranche of MFA was made conditional on certain structural reform requirements. The annex to the Memorandum of Understanding contained these structural conditionalities. Similarly, disbursement of the third tranche of MFA was made conditional on additional structural reform requirements. These conditionalities were part of the Supplementary MoU.

Table 6.2 lists the conditionalities of both the MoU and the SMoU. They can be grouped into three main areas: (1) public finance reform and administration; (2) financial sector reform; (3) private sector development and the business environment.

### Table 6.2 Structural conditionalities of the MoU and SMoU

| Sector | Conditionalities listed in the MoU | Conditionalities listed in the SMoU |
|---|---|---|
| **Public finance reform and administration** | | |
| **Treasury system** | The state and entity authorities will apply the treasury system with a view to ensuring strengthened budgetary discipline. | The state and entity authorities will continue to apply the treasury system. In particular, in the Federation at least seven cantons will apply the treasury system; in the Republika Srpska five municipalities will run pilot projects on the treasury system, and at least three will apply the system. |
| **State Border Service (SBS)** | The state authorities will ensure proper functioning of the State Border Service through appropriate funding. | |
| **Excises** | The Entities and Brcko District will implement the laws which have established the excise attribution mechanism, and stop double taxation on excises. | The Entities and Brcko District will continue to implement the laws which have established the excise attribution mechanism, and thereby avoid double taxation on excises. |
| **Customs and tax administration** | Any changes to the current indirect tax system should retain or strengthen the principle of harmonisation. | The Council of Ministers will adopt the Interim Law Merging the Customs Administration and Establishing the Indirect Taxation Authority, as proposed by the Indirect Tax Policy Commission (ITPC), and submit it to the State Parliament. Moreover, the Framework Law, including general VAT legislation, will be submitted for parliamentary consideration. |
| | The authorities will continue to cooperate closely with the Customs and Fiscal Assistance Office (CAFAO) in order to achieve an efficient customs and tax administration, combat fraud and tax evasion, and increase the harmonisation of the tax systems of the two Entities in order to enhance revenue collection and promote the creation of a single economic space. | |
| | Entity Governments and the Council of Ministers will have adopted an overall implementation strategy for the unification of the customs administration activities of the two Entities and Brcko District. This strategy will not prejudice the principle of entity ownership of customs revenue. | |
| **Statistics** | The three statistical agencies will have made progress on the harmonisation of statistics by completing the tasks as foreseen in the 'Plan of Activities 2002-2003' on the harmonisation of statistics. | The three statistical agencies will continue to make progress on the harmonisation of statistics by completing the tasks as foreseen in the 'Plan of Activities 2002-2003' on the harmonisation of statistics. In particular, the indicator on industrial activity will be harmonised at state level. |

| Sector | Conditionalities listed in the MoU | Conditionalities listed in the SMoU |
|---|---|---|
| | The authorities will have appointed a new Director of the Statistical Agency of Bosnia and Herzegovina in accordance with the new state-level Law on Statistics, which came into force in October 2002. | Following the appointment of the Director of the SABH, a Statistical Council will be established and a chairperson will be nominated, with a view to start drafting the internal book of rules and regulations. |
| **Public procurement** | | The Bosnia and Herzegovina Governments will submit to the State and Entity Parliaments draft legislation on public procurement. |
| | **Financial sector reform** | |
| **Privatisation of banks** | All remaining state-owned banks will have been privatised according to the timetable prescribed by law. Those state-owned banks which have not been privatised by the final deadline will undergo bank resolution procedures, as prescribed by law. | |
| **Banking supervision** | Banking supervision will be strengthened by enforcing the current prudential regulations. Banks which do not meet current prudential regulations will undergo bank resolution procedures, as prescribed by law. | Banking supervision will be strengthened by enforcing the current prudential regulations. In particular, the authorities will ensure that under-capitalised banks are under administration or their licences are withdrawn. In addition, the Bosnia and Herzegovina authorities will amend regulations on banks' foreign currency exposures to include assets and liabilities indexed to foreign currencies (starting with non-Euro currencies by end-June 2003). |
| | | In order to strengthen the soundness of the banking system, banks will comply with the requirements of the State Deposit Insurance Agency. |
| **Insurance** | The Council of Ministers of BiH will have approved the State Framework Law on Insurance and submit it to Parliament. The Entity Governments will have finalised the draft harmonised insurance legislation with a view to submitting these laws to the appropriate Parliaments in the second quarter of 2003. | The State Insurance Commission will have begun functioning, on the basis of the adopted State Framework Law. The Entity Parliaments will have adopted harmonised insurance legislation. |
| | **Private sector development and business environment** | |
| **Bankruptcy** | Entity Governments will have adopted harmonised laws on bankruptcy and liquidation. | With a view to accelerating the handling of bankruptcy cases, based on the harmonised bankruptcy legislation, the authorities will ensure proper functioning (including staffing, premises and equipment) of the commercial departments |

| Sector | Conditionalities listed in the MoU | Conditionalities listed in the SMoU |
|---|---|---|
| | | established within municipal and basic courts under the 1 November 2002 amendments to the laws on courts. |
| **Privatisation** | On advice of the IAUP, the RS Government will submit to Parliament a proposal to revoke those amendments to the Law on Privatisation recently adopted by the RS National Assembly (RSNA), which obstruct the privatisation process. The Federation will have offered for sale at least four additional companies from the list of 56 strategic enterprises. | Republika Srpska will offer for sale at least six additional companies from the list of 80 strategic enterprises. The Federation will offer for sale at least another eight additional companies from the list of 56 strategic enterprises. |
| **Competition** | The state authorities will implement the Competition Law. In particular, they will have adopted an action plan on the Competition Council, thereby fostering the development of a single economic space. | The state authorities will implement the Competition Law. In particular, they will establish the Competition Council and appoint its members, thereby fostering the development of a single economic space. |
| **Veterinary office** | | The State Veterinary Office will become fully operational by 1 October 2003; in particular, it will establish certification procedures for meeting EC certification requirements for the export of meat and animal products, so as to take advantage of autonomous trade measures granted to Bosnia and Herzegovina by the EU. |
| **Phytosanitary office** | | The State Parliament will approve national phytosanitary legislation by 15 October 2003 to improve the quality of plants and seeds for domestic and export markets. The authorities will prepare sub-legislation and establish a state-level phytosanitary office, which would also represent Bosnia and Herzegovina in international phytosanitary issues. |

## 6.3 Relevance of MFA's structural objectives

*Q2.2 How relevant are the short and medium-term expected structural effects of the assistance to the needs of the recipient country?*

From the perspective of the MFA objectives, the selection of conditionalities should be driven by the need to prevent future balance of payment and/or budgetary crises by strengthening the economic base of the country and the management of public finances.

### 6.3.1 Findings from the Delphi questionnaire

Two questions included in the Delphi questionnaire provided indications of the relevance of the MFA conditionalities. Table 6.3 shows respondents' assessment of the relevance of the conditionalities taking into account the economic conditions of the country when MFA was negotiated. Although some variance can be observed, a broad consensus on the sound economic rationale of the conditionalities is apparent. Generally speaking, the experts who responded to the questionnaires considered all conditionalities to be fairly relevant to the BiH policy agenda at that time.

**Table 6.3 Responses to the question 'How would you assess the importance of proposing the following structural reforms in the BiH policy agenda at that time [2002]?'** [14]

| Conditionality | Inappropriate priority | Minor issue | Important issue | Key priority | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | 1 | 2 | 11 | - |
| Customs and indirect tax reform | | - | 2 | 12 | - |
| Public procurement | 1 | | 5 | 8 | - |
| Bank privatisation | | 2 | 7 | 5 | - |
| Banking supervision | | 1 | 4 | 9 | - |
| Deposit insurance | | 4 | 3 | 6 | 1 |
| Implementation of bankruptcy law | | | 5 | 8 | 1 |
| Large-scale privatisation | | | 3 | 10 | 1 |
| Competition policy | 1 | 1 | 8 | 4 | - |
| Phytosanitary standards | | 4 | 4 | 5 | 1 |
| Meat and animal product standards | | 3 | 4 | 5 | 1 |
| Harmonisation of statistics | | 3 | 8 | 3 | - |

Table 6.4 shows the prevailing perceptions among respondents about the sense of urgency of the BiH authorities regarding the various policy items in the structural reform agenda. Findings were more varied here. Six items were thought to have been so relevant to the BiH authorities that it was believed they would have acted even without any international pressure. For six other items, relevance to the BiH authorities was considered to be lower in the sense that spontaneous efforts on their part could not be expected. In particular, there was an apparent lack of appreciated urgency in the areas of bankruptcy, competition policy and statistical harmonisation.[15]

However, it is worth remembering that BiH is a potential candidate country that ought gradually to incorporate the EU *acquis* (body of law). Hence Commission staff acknowledged that MFA was also used to boost reforms aimed at incorporating EU principles and norms. This, in a way, was irrespective of the degree of truly local ownership.

[14] The responses of BiH representatives did not diverge greatly from the responses of international interviewees. Generally speaking, international experts were more radical than local respondents in considering implementation of the bankruptcy law as a key priority and softer in appreciating the importance of agricultural products standards (see Table 1 in Annex 3).

[15] For almost all reform items, respondents from international organisations appeared to be even more pessimistic than local respondents in their assessment of the likelihood that the BiH Government would have taken action without external pressure (see Table 2 in Annex 3).

**Table 6.4 Responses to the question 'If the MFA had not existed AND the Government had been forced to fill the financing gap with autonomous moves towards speeded-up structural reforms, what is your assessment of the likelihood it would have taken action in the following policy areas?'**

| Conditionality | Very unlikely | Unlikely | Likely | Very likely | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | 4 | 6 | 3 | 1 |
| Customs and indirect tax reform | 3 | 2 | 4 | 4 | 1 |
| Public procurement | 1 | 4 | 7 | 0 | 1 |
| Bank privatisation | 1 | 2 | 6 | 3 | 2 |
| Banking supervision | 1 | 4 | 9 | - | - |
| Deposit insurance | 1 | 7 | 5 | - | 1 |
| Implementation of bankruptcy law | 2 | 7 | 4 | - | 1 |
| Large-scale privatisation | 2 | 2 | 6 | - | 4 |
| Competition policy | 2 | 7 | 2 | - | 3 |
| Phytosanitary standards | | 4 | 4 | 1 | 5 |
| Meat and animal product standards | | 5 | 4 | | 5 |
| Harmonisation of statistics | 1 | 6 | 3 | - | 4 |

### 6.3.2 Findings from interviews

All in all, the economic rationale behind the selection of conditionalities appeared to be broadly shared by the representatives of the various stakeholders interviewed. As such, the relevance of the MFA conditionalities was never disputed.

However, as confirmed by several EC representatives, the selection of conditionalities was not driven by economic motives alone. Another major influence that shaped the conditionalities was the international community's intention of strengthening the institutional base of the country at state level. This parallel objective was reflected in the conditionalities on customs and tax reform, the pursuit of a single economic space (harmonisation of banking and insurance supervision institutions) and the establishment of state institutions such as the competition agency and veterinary and sanitary agencies.

Support for this inherently political objective was substantially lower at entity level and in particular in Republika Srpska. There, respondents generally demonstrated a limited willingness to transfer authority to the State Government. For them, the need to organise economic issues at state level was not sufficiently felt.

Consequently, interviewees complained that a substantial amount of time was 'wasted' on disputes to settle organisational issues. Since the EU conditionalities 'pushed' them to accept transfer of authority to state-level institutions, this was seen as not only against the Dayton Agreement, but also allegedly caused inefficiency because of an additional layer of government. This explains their reluctance to hand over responsibilities to state-level institutions.

### 6.3.3 Conclusions

Each MFA conditionality can be considered as relevant to the economic conditions of the country at the time when the MFA was negotiated. The question of relevance to the policy agenda of the BiH authorities is more equivocal. Some of the conditionalities were not necessarily considered to have been a real priority by the BiH authorities. Furthermore, some parts of the conditionalities were controversial for some of the BiH authorities as they entailed strengthening institutions at state level.

## 6.4 Gross impact – actual structural reform outcomes

*Q2.3 To what extent have the short and medium-term expected structural effects of the assistance (in the context of the recipient country's reform programme) occurred as envisaged?*

To assess the progress and impact of structural reforms, the following sources were used:

- document analysis – the assessment of progress is based on the *BiH progress report* (EC, 2006), *BiH: financial system stability assessment* (IMF, 2006) and *Public Expenditure and Institutional Review* (World Bank, 2006);
- semi-structured interviews with representatives of the BiH government institutions, IMF, World Bank and EU Delegation to verify the developments in the targeted sectors;
- the European Bank for Reconstruction and Development (EBRD) transition indicators;
- the Delphi questionnaire.

### 6.4.1 Findings from document analysis and interviews

*I Public finance and administrative reform*

*Treasury system.* The conditionality was fully met. The two Entity Governments are now using the treasury system. In FBiH, the same automated treasury system has also been implemented by the cantonal authorities. In the RS, the system has been piloted in 18 municipal treasuries. Generally, the automated treasury system has improved budgetary controls, brought discipline to the budgetary execution system, and improved overall cash management across the State and Entities. As such, it can be said that the conditionality has effectively contributed to more efficient management of public finances.

*State Border Service.* The conditionality was fully met. In 2005, the Council of Ministers adopted new regulations on the internal organisation of the SBS and decided to increase its staff from 2,000 to 2,500. In July 2005, BiH also adopted the Integrated Border Management Strategy. This has successfully brought about enhanced administrative cooperation between the State Border Service, Indirect Tax Authority, phytosanitary and veterinary services and market inspection office.

*Customs and tax administration/excises.* The conditionality was fully met. Major changes to the fiscal architecture of the country took place under the Law on the Indirect Taxation

System (2003), which provides for a unified indirect taxation system. As stipulated by this law, indirect taxation encompasses import and export customs duties, excise duties, VAT and all other taxes calculated for goods and services, including sales tax and road tolls.

As a consequence of this law, in January 2005 the customs administrations of the Entities and the Brcko district were merged into a single state-level administration – the BiH Indirect Taxation Authority. All this has reportedly led to more efficient taxation and tax collection, increased tax compliance and prevention of fraud. As for indirect taxation, further progress has been achieved by the introduction of a single VAT on 1 January 2006. VAT collection in 2006 exceeded expectations, though difficulties are still faced in allocating revenues to the Entities.

As part of customs and taxation reform, BiH established a single account and adopted the Law on Payment to the Single Account and Revenue Distribution. The system began to operate in January 2005, but some aspects of the revenue distribution procedure still appear controversial and it involves frequent, time-consuming negotiations between the Entities. So far, there has been little progress on selecting a long-term indirect tax revenue reallocation model. However, proposals are being discussed.

*Statistics.* The MFA conditionality was only partially met. Progress was achieved with the establishment of a Statistical Council. Moreover, the entity-level statistical offices signed an ‘Agreement on the implementation of harmonised methodologies and standards in preparing statistical data on Bosnia and Herzegovina’. As a result of this agreement, institutions at entity level are obliged to use statistical standards, methodologies, classifications and nomenclatures regulated by the state-level Statistical Agency of Bosnia and Herzegovina.

However, actual implementation of the agreement has faced several difficulties. The functioning of the Statistical Council remains cumbersome and the SABH lacks real administrative capacity. These institutional problems are reflected by the general observation that the quality and availability of economic statistics are still insufficient. For instance, knowledge is lacking about the number of people living in the country (estimates are roughly 4 million), and according to some GDP may be underestimated by half. More specifically, the MFA conditionality about harmonisation of the indicator on industrial activity at state level has not really been implemented yet.

*Public procurement.* The conditionality was formally met. In November 2004, a new Public Procurement Law came into force. The FBiH has been applying it since January 2005 and the RS started applying it in mid-2005. The law established a Public Procurement Agency responsible for implementing regulation and for issuing related by-norms. Furthermore, it envisaged the establishment of a Procurement Review Body (PRB) to decide on appeals filed by bidders who believe that the contracting authority has breached one or more provisions of the law.

The effects of this law have been softened by operational problems in establishing the Public Procurement Agency, such as a delay in appointing its director. There were similar problems in the functioning of the Procurement Review Body. This was established with substantial delay in December 2005. Moreover, after its establishment the PRB lacked the quorum necessary to make decisions on tender appeals as three of its six members resigned. The PRB finally resumed its work in August 2006, as a fourth member was appointed.

### *II Financial sector reform*

*Privatisation of banks.* From a purely formal point of view, the conditionality was not met as six banks – accounting for 13% of total banking sector capital – have remained under state ownership in the FBiH. Nevertheless, progress in privatising the banking system can be considered substantial. In the RS, privatisation has been completed and the market for banking services has experienced substantial growth. Total deposits have increased from 68.6% to 80% of GDP. Lending to the private sector has expanded from 38% to 46% of GDP. Foreign banks dominate the sector and represent 73% of total capital. Like indirect tax reform, interviewees generally considered the privatisation of banks as a very successful reform area.

*Banking supervision.* Banking supervision is still conducted by two separate supervisory banking agencies in the FBiH and RS according to separate, though similar, entity-level legislations. For both entities, the MFA conditionality on banking supervision was fully met and the IMF's *Financial system stability assessment* concludes that prudential regulations are generally sound in both the FBiH and RS (IMF, 2006).

However, in both Entities, a key weakness in adequate supervision concerns the lack of legal protection from political interference, which compromises the independence of supervisors. To achieve adequate independence (through legal protection and sufficient resources), the IMF urges the establishment of a *unified* banking supervisor at state level independent from the Entity Governments. However, a draft banking law that aimed to unify supervision within the Central Bank was not approved by both Entities' Parliaments.

*Insurance.* The MFA conditionality was fully met. The members of the administrative board of the State-level Insurance Supervisory Agency and the agency's director were appointed in December 2005. Furthermore, a State Framework Law was adopted.

However, the State-level Insurance Supervisory Agency is not yet fully operational as staff recruitment only started in late 2006. Furthermore, the State Framework Law does not transfer supervisory competences to the state-level agency and insurance supervision continues to remain *de facto* at entity level.

### *III Private sector and business environment*

*Bankruptcy.* The conditionality attached to the MoU was fully met, as in 2003 the Entity Governments adopted the new bankruptcy legislation. However, it can be argued that the structural effects were not those anticipated, as the harmonised law includes preferential creditor status for workers. This is not necessarily in line with international best practice in this field, and may ultimately negatively affect the attractiveness of the business environment for potential investors.

Assessment of the conditionality attached to the SMoU is somewhat more ambiguous. The procedure has been speeded up, as the average processing time has been reduced from three to two years. However, a substantial backlog of companies facing insolvency have not yet entered the bankruptcy procedure and are not included in the average processing time.

*Privatisation.* The conditionality was fully met (see section 7.3). Of the list of 56 strategic enterprises in the FBiH, 22 have been privatised. In the RS, 58 strategic companies have been sold.[16]

The country's structural progress on privatisation of strategic enterprises is uneven. In the last two years, the RS Government has demonstrated commitment to achieve further progress in the privatisation process, while progress in the FBiH has stagnated. In the RS, 15 more strategic enterprises have been privatised in the last two years. The sale of Telecom Srpska in December 2006 was the latest transaction, reflecting substantial progress in the Republic's commitment to privatisation. In the FBiH, only seven strategic enterprises have been privatised in the last two years. Privatisation in the Federation remains cumbersome because of lack of political will, a complex institutional decision-making structure and an inadequate legal framework.

*Competition.* The conditionality was met. The Competition Council was established in May 2004 as an independent public body mandated to ensure consistent implementation of the Competition Act (July 2005). Since January 2006, the Entities' competition offices have become part of the Competition Council. The Competition Council has carried out a number of investigations and issued several opinions. Of 25 filed cases, 18 have so far been resolved by binding decisions.

*Veterinary office/phytosanitary office.* Assessment of the conditionalities on veterinary and phytosanitary issues is not clear cut. The State Veterinary Office and State Phytosanitary Office are both operational. However, their operations are still severely limited by lack of human and financial resources and inadequate coordination between state and entity veterinary services. Although the State Veterinary Office has adopted all necessary regulations and prepared monitoring plans, there is a shortfall in actual implementation. The limited progress is reflected by the fact that, so far, Bosnia and Herzegovina has not been allowed to export meat products to the EU market. Progress by the State Phytosanitary Office in preparing national regulation is considered even more limited.

### 6.4.2 Transition indicators

Further evidence of the progress made by the BiH authorities in the various reform areas is provided by EBRD transition indicators. Table 6.5 provides a comparative summary overview of progress achieved in BiH over the period 1997-2005 in some MFA-relevant

[16] Precise assessment of the conditionality is problematic as the original list of 80 strategic enterprises in the RS referred to in the conditionality could not be replicated by the RS Privatisation Agency. The agency's operational list includes 164 enterprises that are labelled 'strategic'.

structural reform areas. The indicators show progress in banking reform and privatisation. However, progress appears to be lacking in the areas of non-bank financial institutions (e.g. insurance) and competition policy.

**Table 6.5 EBRD transition indicators for Bosnia and Herzegovina**

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| Large-scale privatisation | 1.00 | 2.00 | 2.00 | 2.00 | 2.33 | 2.33 | 2.33 | 2.33 | 2.67 |
| Small-scale privatisation | 2.00 | 2.00 | 2.00 | 2.33 | 2.67 | 3.00 | 3.00 | 3.00 | 3.00 |
| Enterprise restructuring | 1.00 | 1.67 | 1.67 | 1.67 | 1.67 | 1.67 | 2.00 | 2.00 | 2.00 |
| Competition policy | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Banking reform and interest rate liberalisation | 1.00 | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 2.67 | 2.67 |
| Securities markets and non-bank financial institutions | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.67 | 1.67 | 1.67 | 1.67 |

Source: EBRD transition reports, various years

### 6.4.3 Findings from the Delphi questionnaire

Table 6.6 shows respondents' assessment of the progress of reforms in the various policy areas. It should be noted that the success criteria do not coincide with the MFA conditionalities. What one respondent might consider a substantial improvement in the field of banking supervision may not have been part of the original wording of the MFA conditionality. Conversely, some respondents might actually consider the attainment of formal results in a number of areas as irrelevant progress.

From the table it can be concluded that there was broad agreement about the achievement of substantial progress in the treasury system, tax and customs reform and bank privatisation. There was less consensus on the assessment of progress in public procurement, banking supervision and deposit insurance. Reform items demonstrating little to no progress were deemed to be bankruptcy law, large-scale privatisation, competition policy, veterinary and phytosanitary standards and statistical harmonisation.[17]

[17] On average, international respondents' appreciation of the situation was broadly in line with that of local respondents (see Table 3 in Annex 3). Only the progress in public procurement was assessed less favourably by international respondents.

Table 6.6 **Responses to the question 'How do you assess progress achieved in the following policy areas in comparison with the situation in mid-2002?'**

| Conditionality | Worsened | The same | A bit better | Much better | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | | 2 | 11 | 1 |
| Customs and indirect tax reform | | 1 | 1 | 11 | 1 |
| Public procurement | | 2 | 5 | 6 | 1 |
| Bank privatisation | | 1 | 3 | 9 | 1 |
| Banking supervision | | 1 | 7 | 6 | - |
| Deposit insurance | | 1 | 5 | 6 | 2 |
| Implementation of bankruptcy law | 1 | 9 | 3 | - | 1 |
| Large-scale privatisation | 2 | 4 | 5 | 0 | 3 |
| Competition policy | | 7 | 5 | - | 2 |
| Phytosanitary standards | | 4 | 6 | - | 4 |
| Meat and animal product standards | | 4 | 5 | - | 5 |
| Harmonisation of statistics | | 6 | 6 | - | 2 |

### 6.4.4 Conclusions

Based on the above findings, the gross impact of the various conditionalities is summarised in Table 6.7. Assessment of gross impact distinguishes between 'formal progress' and 'structural progress'. A conditionality is assessed as having achieved *formal progress* if it has been fulfilled in accordance with the literal formulation of the conditionality. A conditionality is assessed as having achieved *structural progress* if the reform has become structurally embedded in the BiH institutional context.

Table 6.7 shows that formal progress has been fully achieved for most of the conditionalities (12 out of 14). Only in the areas of statistical harmonisation and banking privatisation is formal progress assessed as 'partly realised'. The number of conditionalities achieving structural progress is lower. Around half of the reforms included in the MFA conditionalities are considered to be structurally embedded in the BiH institutional context in 2006.

Table 6.7 **Overview of assessment of the gross impact of MFA conditionalities**

| Conditionality | Formal progress | Structural progress |
|---|---|---|
| **Public finance reform and administration** | | |
| **Treasury system** | Fully realised | Substantial |
| **State Border Service** | Fully realised | Substantial |
| **Excises** | Fully realised | Substantial |
| **Customs and tax administration** | Fully realised | Substantial |
| **Statistical harmonisation** | Partly realised | Limited |
| **Public procurement** | Fully realised | Limited |
| **Financial sector reform** | | |
| **Privatisation of banks** | Partly realised | Substantial |
| **Banking supervision** | Fully realised | Limited |

| Conditionality | Formal progress | Structural progress |
|---|---|---|
| **Insurance** | Fully realised | Limited |
| **Private sector development and business environment** | | |
| **Bankruptcy** | Fully realised | Limited |
| **Privatisation** | Fully realised | Limited (FBiH), substantial (RS) |
| **Competition** | Fully realised | Limited |
| **Veterinary office** | Fully realised | Limited |
| **Phytosanitary office** | Fully realised | Limited |

## 6.5 Synergies with other instruments of the EU, IMF and World Bank

*Q2.5 To what extent have structural effects been enhanced, if at all, by complementarities between the MFA and other EU instruments?*

Based on document analysis, this section addresses the synergies of MFA conditionalities with other EU initiatives and the programmes of the World Bank and IMF. It also provides background on the rationale behind the existence of such synergies, based on findings from interviews. This is followed by the findings from the Delphi questionnaires.

### 6.5.1 Findings from document analysis

In order to map complementarities with the MFA conditionalities, the BiH programmes of three actors were included in the document analysis:
- EU Stabilisation and Association Process (SAP);
- World Bank;
- IMF Stand-by Arrangement 2002-2004.

Obviously, synergies between the MFA conditionalities and other EU instruments were found, mainly with the SAP. In November 2003, the EC finalised a feasibility study concerning the opening of negotiations on a Stabilisation and Association Agreement (SAA). The feasibility study identified 16 priority tasks for BiH to achieve prior to opening SAA negotiations. The EU approved the start of SAA negotiations, which officially opened on 25 November 2005.[18] The progress of BiH in the SAP has been supported by specific project support through the CARDS programme. In the period 2002-2005, BiH received around € 250 million from this programme.[19]

During the term of the MFA operation, Bosnia and Herzegovina received support from the World Bank through various instruments. Table 6.8 lists those World Bank instruments which can be related to the MFA conditionalities.

[18] The transferring of controls over the police from entity level to the central Government proved to be the most difficult obstacle to overcome. The Parliament of Republika Srpska repeatedly rejected EU proposals to unify and reorganise police structures across entity lines. Finally, in early October the EU and RS reached a compromise agreement that adhered to EU principles on state-level control over the police, but postponed decisions on a number of related disputed items.

[19] Source: website, EU Delegation, Bosnia and Herzegovina.

Table 6.8 World Bank instruments overlapping with MFA conditionalities (in € millions)

| Instrument | Year | Budget |
|---|---|---|
| Public Finance Structural Adjustment Credit (PFSAC) | June 1999 - December 2002 (closed) | € 72 |
| Enterprise and Bank Privatisation Adjustment Credit (EBPAC) | June 1999 - May 2002 (closed) | € 50 |
| Privatisation Technical Assistance Credit (PTAC) | June 2001 - August 2006 (closed) | € 20 |
| Business Enabling Environment Structural Adjustment Credit (BAC) | May 2002 (ongoing) | € 44 |
| Economic Management Structural Adjustment Credit (EMSAC) | June 2004 (ongoing) | € 34 |
| | | |

Finally, the IMF Stand-by Arrangement with BiH which ended in 2004 included, in addition to the macroeconomic requirements, specific conditionalities for BiH's economic and financial policies.

In Annex 3, the MFA conditionalities are mapped in detail against the priority tasks of the EU-SAP, the relevant World Bank programmes and the economic and financial policy requirements included in the IMF SBA. Table 6.9 summarises Annex 3 by marking the areas of structural reform where synergies were identified. The table shows that none of the conditionalities were entirely specific to the MFA. Most of them (10 out of 14) were part of the broader international reform agenda as reflected by the programmes of the World Bank and IMF. The others contained synergies with the requirements of the EU-SAP, and as such reflected the specific EU reform agenda for BiH.

Table 6.9 Synergies between MFA conditionalities and EU-SAP, World Bank and IMF programmes

| Conditionality | EU-SAP | World Bank | IMF |
|---|---|---|---|
| **Treasury system** | √ | √ | √ |
| **State Border Service** | √ | √ | √ |
| **Excises** | √ | √ | √ |
| **Customs and tax administration** | √ | √ | √ |
| **Statistical harmonisation** | √ | √ | √ |
| **Public procurement** | √ | √ | |
| **Privatisation of banks** | | √ | √ |
| **Banking supervision** | | √ | √ |
| **Insurance supervision** | √ | | |
| **Bankruptcy** | | √ | √ |
| **Privatisation** | | √ | √ |
| **Competition** | √ | | |
| **Veterinary office** | √ | | |
| **Phytosanitary office** | √ | | |

### 6.5.2 Findings from interviews

The synergies between MFA and the SAP conditionalities are explained by the close cooperation in formulating the conditionalities between DG ECFIN and those in charge of the SAP at DG ELARGE (Enlargement Directorate General). Representatives of the European Commission confirmed their intention to achieve complementarity in their efforts to induce the BiH authorities to reform.

The synergies between MFA and the World Bank conditionalities demonstrate a shared perspective by the international community on the reform priorities for Bosnia and Herzegovina. The very presence of the international community, through the Office of the High Representative and the existence of a Peace Implementation Council, is likely to have contributed to such a common international agenda.

### 6.5.3 Findings from the Delphi questionnaire

The Delphi questionnaire included a question on the perceived impact of MFA versus the instruments employed by other actors in the international community. The results are shown in Table 6.10. From this table it can be seen that MFA was attributed as having had significant weight in influencing the reforms across nearly all conditionalities. The exception was banking privatisation, in which the World Bank was perceived to have led the reforms. On the other hand, in none of the reform areas apart from 'deposit insurance' and 'competition policy' was MFA considered to be the only leading actor. Each of the reforms was driven by at least two actors. Finally, in line with Table 6.9, a number of distinct EU conditionalities are included in addition to the reforms carried forward by the entire international community.

**Table 6.10 Responses to the question: 'Whenever progress was achieved, what in your opinion was the relative weight of the incentive provided by external influence factors?'**

| Conditionality | IMF | MFA | World Bank | EU SAA CARDS |
|---|---|---|---|---|
| Application of the treasury system | High | High | Low | None |
| Customs and indirect tax reform | High | High | Low | High |
| Public procurement | Low | High | High | High |
| Bank privatisation | Low | Low | High | None |
| Banking supervision | High | High | Low | None |
| Deposit insurance | Low | High | Low | Low |
| Implementation of bankruptcy law | High | High | Low | Low |
| Large-scale privatisation | Low | High | High | Low |
| Competition policy | Low | High | Low | Low |
| Phytosanitary standards | None | High | None | High |
| Meat and animal product standards | None | High | None | High |
| Harmonisation of statistics | Low | High | None | High |

### 6.5.4 Conclusions

The analysis in this section has shown that there were substantial synergies between the MFA conditionalities and the conditionalities included in the EU-SAP process, the IMF Stand-by Arrangement and various World Bank programmes. It can be concluded that none of the conditionalities were specific to the MFA. Most of them were part of the broader international reform agenda and were also included in the programmes of the World Bank and IMF. Some of the conditionalities appear to have been specific to the EU strategy, as reflected by their synergies with the requirements of the EU-SAP.

## 6.6 Net impact on structural reforms

*Q2.4 What has been the contribution of actions resulting from the respect of structural conditionality criteria to the occurrence of expected structural effects?*

The net effect of MFA is determined by comparing actual developments (gross effects) with the counterfactual scenario in which Bosnia and Herzegovina would not have received MFA support. To assess the net impact of the structural reforms, we employed the following methods:

- Delphi method questionnaire;
- semi-structured interviews with key stakeholders;
- case studies of the conditionalities on indirect tax reform and privatisation;
- deductions based on other findings.

### 6.6.1 Findings from the Delphi questionnaire

*Counterfactual scenarios*

Section 6.3.1 indicated the MFA conditionalities which were considered to be very relevant to the BiH authorities and which they would have acted on even without international pressure. It also indicated those conditionalities which were considered to be less relevant to the BiH authorities, such that spontaneous efforts could not be expected.

The Delphi questionnaire included another question to assess possible counterfactual scenarios. The responses are shown in Table 6.11.

**Table 6.11 Responses to the question 'What would have happened to the following conditionalities if the MFA had not existed?' (11 respondents, multiple answers possible)**

| Conditionality | Would have been incorporated in IMF programme | Would have been incorporated in a WB programme | Would have been strengthened under SAA or CARDS | Would have become part of government agenda | Would have been neglected |
|---|---|---|---|---|---|
| Treasury system | 5 | | 2 | 2 | |
| Customs and indirect tax reform | 4 | | 3 | 3 | 1 |
| Public procurement | 3 | 2 | 2 | 1 | |

| Conditionality | Would have been incorporated in IMF programme | Would have been incorporated in a WB programme | Would have been strengthened under SAA or CARDS | Would have become part of government agenda | Would have been neglected |
|---|---|---|---|---|---|
| Bank privatisation | 5 | 3 | 1 | 2 | 1 |
| Banking supervision | 5 | 4 | | 1 | 1 |
| Deposit insurance | 4 | 5 | | 2 | 1 |
| Bankruptcy law | 4 | 4 | | | 2 |
| Large-scale privatisation | 3 | 3 | | | 2 |
| Competition policy | 1 | | 5 | 1 | 1 |
| Phytosanitary standards | 1 | 1 | 5 | | 1 |
| Meat and animal product standards | 1 | 1 | 5 | | 1 |
| Harmonisation of statistics | 2 | | 6 | | 1 |

Most respondents were under the impression that the structural reform programme was broadly agreed between the EU and the IFIs, so that if MFA had not been there, the task of reinforcing related conditionalities would have been taken over by one of the other IFIs, including deposit insurance which was not originally on their agenda. Only a few policy areas – competition policy, phytosanitary and meat standards and statistical harmonisation – were considered to be of EU concern only. The only possible substitute for the MFA programme was perceived to be the SAP or the CARDS strategic document.

*Net impact of MFA*

Since MFA was deemed to have exerted some influence on the development of reforms across nearly the whole array of conditionalities, Table 6.12 shows how Delphi respondents perceived the mechanism through which MFA influenced progress in reforms. For six of the proposed reform areas, MFA was believed to have accelerated the pace of reforms. For the other six it was deemed to have contributed mainly to shaping the content of the reforms, as progress in implementation was often deemed lacking.

**Table 6.12 Responses to the question: 'What, if any, was MFA's contribution to conditionality fulfilment?' (number of respondents who agreed)**

| Conditionality | Speeded up delivery | Shaped contents of reforms |
|---|---|---|
| Application of the treasury system | 9 | 3 |
| Customs and indirect tax reform | 7 | 4 |
| Public procurement | 4 | 5 |
| Bank privatisation | 6 | 3 |
| Banking supervision | 5 | 4 |
| Deposit insurance | 2 | 1 |
| Implementation of bankruptcy law | 2 | 1 |
| Large-scale privatisation | 2 | 4 |
| Competition policy | 1 | 4 |
| Phytosanitary standards | 1 | 4 |
| Meat and animal product standards | 1 | 4 |
| Statistical harmonisation of industrial | 3 | 3 |

| Conditionality | Speeded up delivery | Shaped contents of reforms |
|---|---|---|
| production data | | |
| | | |

### 6.6.2 Findings from interviews

Interviews were conducted with high-level EC officials and high-level representatives of the Bosnian authorities. Their perspectives largely coincided.

First, interviewees emphasised that the MFA conditionalities were selected taking their feasibility into consideration. In other words, conditionalities were chosen that were in line with reforms that had already begun. As such, the reforms would have been realised without MFA support. The added value of MFA concerned its contribution to the speed of implementing reforms. Interviewees from the Bosnian authorities confirmed this accelerating effect of MFA: *'reforms would have taken their natural flow. However, without the MFA the reforms would have been implemented much slower.'*

Secondly, the MFA conditionalities reflected to a great extent the international reform agenda shared with the EU-SAP, the IMF and the World Bank. Based on the interviews, it can be concluded that MFA should not be considered as the instrument that has driven the reform efforts of the BiH authorities. In particular, the prospect of accession to the EU has induced reform activities. One EU official phrased the effect of MFA as follows: *'There are more horses pulling in the same direction. The carrot to induce BiH to reform is definitely the SAA. This is the main force driving reforms.'* Nevertheless, EC officials interviewed believed that the conditions of MFA support have accelerated the reform process by the BiH authorities. This view was confirmed in interviews with representatives of the BiH authorities.

### 6.6.3 Findings from case studies

*Case study on indirect tax reform*
The case study on indirect tax reform is described in section 7.2. The main conclusion from this case study is that the MFA conditionality has supported the reforms in tax legislation, indirect tax revenue collection and state-level institution building. The MFA conditionality has provided additional support for these reforms, especially by restating and politically reinforcing the importance of these reforms to the State and Entity Governments on behalf of all international and bilateral supporters of Bosnia and Herzegovina in general and the EU in particular.

*Case study on privatisation*
The case study on privatisation is elaborated on in section 7.3. From this case study, it is concluded that the MFA conditionality on privatisation has not influenced developments in privatisation in Bosnia and Herzegovina. External financial incentives have played only a minor role in the complex institutional setting in which privatisation is taking place.

### 6.6.4 Deductions from other findings

The net impact of the MFA structural conditionalities can also be deduced from three findings presented earlier in this chapter:

- Gross effect of the conditionalities. Section 6.4 concluded that for some conditionalities only ‘formal progress’ has been achieved, while other reforms have become structurally embedded in the BiH institutional context (‘structural progress’).
- The likelihood that in the absence of MFA, the BiH authorities would have taken action by themselves in fostering the reforms. Section 6.3 concluded that the relevance to the BiH authorities of some conditionalities was sufficiently high to assume that they would have acted on them even without international pressure. However, the relevance of other conditionalities was considered to be lower. In those policy areas, the BiH authorities would not have been expected to have initiated the reforms by themselves.
- The likelihood that in the absence of MFA, the reforms would have been implemented following external pressure by other actors in the international community. Section 6.5 concluded that none of the conditionalities were entirely specific to the MFA. The majority of them were part of the broader international reform agenda as reflected by the programmes of the World Bank and IMF. Some of the conditionalities reflected just the more specific EU agenda. In line with these findings, Table 6.11 shows that in a counterfactual scenario in which there was no MFA, the MFA conditionalities would have been substituted either by the other IFIs or by the EU-SAP.

The above findings are summarised in Table 6.13.

**Table 6.13 Net impact of MFA’s structural conditionalities: three categories**

| | Category A | Category B | Category C |
|---|---|---|---|
| **Gross effect of conditionalities** | Structural progress | Formal progress | Formal progress |
| **Degree of synergy of MFA conditionalities with reform agenda of IFIs** | High | Low | High |
| **Degree of ownership among BiH authorities** | High | Low | Low |
| **Conditionalities** | • Treasury<br>• Customs reform<br>• Indirect tax reform<br>• Banking privatisation | • Competition policy<br>• Insurance supervision<br>• Veterinary office<br>• Phytosanitary office | • Large-scale privatisation<br>• Banking supervision<br>• Bankruptcy<br>• Statistics |
| **Net impact of conditionalities** | Acceleration of structural progress | Preparing the ground for future structural progress | Negligible net effect |
| | | | |

Category A includes the conditionalities on reform of the treasury system, customs and indirect tax reform and banking privatisation. The conditionalities in this category share the following characteristics. First, progress in these reform items was structural. Secondly, there was synergy between the MFA conditionalities and the reform agenda of the World Bank and IMF. Thirdly, the Bosnian authorities' perception of the relevance of these conditionalities was high. Based on these characteristics, the success of the reform efforts in these policy areas cannot be ascribed to MFA alone, but needs to be shared with the efforts of the BiH authorities and the broader international community. Nevertheless, MFA has made a contribution to the achievement of structural progress. Most of these conditionalities have contributed to the achievement of short and medium-term macroeconomic objectives. In line with the other findings in this section, the MFA has made its contribution by politically reinforcing the importance of the reforms and, by so doing, has accelerated the speed of the reforms.

Category B includes the conditionalities on competition policy, veterinary and phytosanitary issues and public procurement. The conditionalities in this category share the following characteristics. First, no structural progress in these reform areas has yet been identified. Secondly, these conditionalities reflected the specific reform agenda of the EU as they contained no synergies with the programmes of the World Bank and IMF. Thirdly, the Bosnian authorities perceived their relevance as low. Based on these characteristics, progress in these reform areas should be ascribed to the combined EU efforts of MFA and SAP as the efforts of the BiH authorities and the broader international community were small. As progress in these areas has so far been limited to compliance with the formal conditions, the net impact is characterised as preparing the ground for future structural progress.

Category C includes the conditionalities on large-scale privatisation, bankruptcy, banking supervision and statistics. The conditionalities in this category share the characteristic that, notwithstanding the synergy with external pressure from the international community, no structural progress in these reform areas has been achieved. The lack of progress can be explained by the low relevance attached to these reform issues by the BiH authorities. In sum, based on the limited progress achieved and the synergies with the World Bank and IMF conditionalities, the net impact of the MFA conditionalities is assessed as negligible. As the case study on large-scale privatisation illustrates, in these reform areas external financial incentives might have played only a minor role in the complex institutional setting pertaining in BiH.

### 6.6.5 Conclusions

The net impact of the MFA structural conditionalities on the reforms which have taken place in BiH is not uniform. A number of conditionalities have accelerated the structural progress achieved in certain reform areas. Others have prepared the ground for future structural progress. For a third group of conditionalities, a distinct net impact could not be identified.

## 6.7 Unexpected impact on structural reforms

*Q3.2 Has the assistance given rise to any unexpected short and medium-term structural effects? What were they and how did they occur?*

Unexpected structural effects of MFA were identified through the structured interviews with relevant stakeholders.

Following the Operational Assessment conducted in August 2004, the Commission considered that prior to release of the third tranche both the state and entity levels had to:

- establish a working group consisting of representatives of the Ministry of Finance and all main budget users, for the preparation of a comprehensive and clear action plan on strengthening internal control;
- issue instructions to budget users on internal control, to include minimal requirements regarding the segregation of duties, in particular accounting, authorising and payment functions/officers.

Through improved internal control on government spending, MFA could have led to wider and permanent changes in the management of public funds. However, the evidence collected so far points to a still relatively underdeveloped mechanism, where procedures have been agreed but implementation still requires substantial strengthening. It therefore appears premature to conclude that MFA has led to any sustainable improvement in this respect. But it has certainly contributed substantially towards putting the issue on the Government's policy agenda, where it presently ranks fairly high judging by the frequency with which interviewees mentioned this item as a future reform priority.

One unexpected effect was identified from the case study on privatisation (see section 7.1), concerning the role of the newly established Competition Council. Establishment of the Competition Council was among the business development conditionalities associated with MFA. It appears that establishment of the council may have hampered progress on another conditionality, large-scale privatisation. The evidence to support this proposition is based on the privatisation of Energopetrol in the FBiH. The case study shows that the privatisation of this strategic enterprise was impeded by political interference. At the end of the process, the Competition Council became involved as the sales agreement was made conditional on its approval. Although the Competition Council has approved the transaction in the end, the extensive time taken to finalise its decision raises suspicions that the council is not shielded from political interference.

It should be noted that there is no evidence that the above finding underlies a *general* tendency for the Competition Council to hamper progress in the domain of privatisation. It may well be only an isolated case. Nevertheless, it suggests that in an institutionally complex environment such as BiH the establishment of a Competition Council may slow down achievement of the conditionality in the domain of privatisation.

# 7 Structural reforms: case studies

## 7.1 Introduction

Two case studies on structural reforms have been elaborated, to allow for a better understanding of MFA causality vis-à-vis other pre-emptive instruments (such as IMF SBA and EU SAP in particular). The case studies provide insights on beneficiaries' perceptions of the costs and benefits of proposed reforms and synergies with EU-funded CARDS and other types of assistance. The first case study looks at indirect tax reform. The second examines the privatisation of strategic enterprises.

## 7.2 Indirect tax reform

### 7.2.1 Introduction

This case study touches on two closely related conditions, namely reforms in customs and excises and tax administration. They are discussed together under the heading of indirect tax reform since the reforms in both areas were very closely connected. These conditions were especially important since at the beginning of the MFA operation the state level did not have its own independent revenue. This was a major obstacle to its functioning, as new state-level institutions had been created.

### 7.2.2 EC assessment of the conditionality

The MoU included the following conditionality for disbursement of the second tranche:

***Excises***
*'The Entities and the Brcko District will implement the laws, which have established the excise attribution mechanism, and stop double taxation on excises.'*

***Customs and tax administration***

- *'Any changes to the current indirect tax system should retain or strengthen the principle of harmonisation.*
- *The authorities will continue to closely cooperate with CAFAO in order to achieve an efficient customs and tax administration, combat fraud and tax evasion, and increase the harmonisation of the tax systems of the two Entities in order to enhance revenue collection and promote the creation of a single economic space.*
- *Entity Governments and Council of Ministers will have adopted an overall implementation strategy for the unification of the two entity and Brcko District*

*customs administration activities. This strategy will not prejudice the principle of entity ownership of customs revenue.'*

The MoU conditionality was assessed by an EC mission that visited Bosnia and Herzegovina in the period 2-6 June 2003. The mission reported as follows:

***Excises***
*'According to the authorities, the excise attribution mechanism, which began operating in July 2002, is fully implemented in both Entities; this was also confirmed by the IMF (part of the SBA conditionality) and CAFAO. [...] Automatically, the implementation of this mechanism stops double taxation, even though it can still be observed on a temporary basis, since the reimbursement of the paid excise in one Entity takes place in the other Entity with a time lag. According to CAFAO, the main issue to be resolved is how to increase inter-entity trade, which, although on an increasing trend, remains below expected levels. Overall though, this condition can be considered as* ***met****. This condition is carried over in the draft SMoU.'*

***Customs and tax administration***
- *'… the two Entities and Brcko aligned their [oil tax] rates at the same level, and since then no other change has occurred. The condition has therefore been* ***fully met****.*
- *… good cooperation was attained at the technical level in both Entities, and progress continues on achieving efficient administrations and combating fraud and tax evasion […] cooperation with the RS is always more problematic, […] however, CAFAO is not negative about RS cooperation. As a result, this condition can be considered as* ***broadly met****.*
- *[…] In late May an agreement has been reached […] on an Interim Law Merging the Customs Administrations and Establishing the Indirect Taxation Authority, and it has been presented to the High Representative. […] this can be considered a major step for the customs reform […] the recent developments can be considered satisfactory and the condition can be considered as* ***broadly met****. Moreover, the ITPC will continue working on a Framework Legislation to replace the Interim Law as soon as possible, covering the whole indirect tax system, including the introduction of VAT and the complete customs merger. For the sake of continuity, and given the importance that the Commission attaches to this issue, further conditionality on this whole issue has been included in the SMoU.'*

The Supplementary MoU included the following conditionality for disbursement of the third tranche:

***Excises***
*'The Entities and the Brcko District will continue to implement the laws which have established the excise attribution mechanism, and thereby avoid double taxation on excises.'*

***Customs and tax administration***
*'The Council of Ministers will adopt the Interim Law Merging the Customs Administration and Establishing the Indirect Taxation Authority, as proposed by the*

*ITPC, and submit it to the State Parliament. Moreover, the Framework Law, including general VAT legislation, will be submitted for parliamentary consideration.'*

The conditionality in the Supplementary MoU was assessed by an EC mission that visited Bosnia and Herzegovina in the period 14-17 June 2004. Their review of the SMoU third tranche conditionality was as follows:

***Excises***
*'The condition in the SMoU seeks to enforce the continued implementation of an existing excise attribution mechanism so as to avoid double taxation at the time of production as well as consumption. The condition corresponds to a structural benchmark criterion in the IMF programme which recently came to an end. The criterion has, as confirmed in the latest IMF report, been successfully implemented as of December 2003 and the condition can therefore be regarded as* ***fully met****.'*

***Customs and tax administration***
*On the customs and taxation reform, the Interim Law (regulating the merger of the customs administrations and the establishment of the Indirect Taxation Authority) was adopted in September 2003 and the ITA has been established […]. A draft of the Framework Law, including VAT legislation, has been sent to the finance and budget committees at entity level for comments. Their comments have not yet been delivered, but the law has, however, recently been sent on to the Council of Ministers (CoM). Given that the entity levels do not have any major remarks, the CoM should soon be able to submit it to Parliament (at state level). This condition is therefore for the time being only* ***partially met,*** *but prospects are good that it will be completed in the very near future.'*

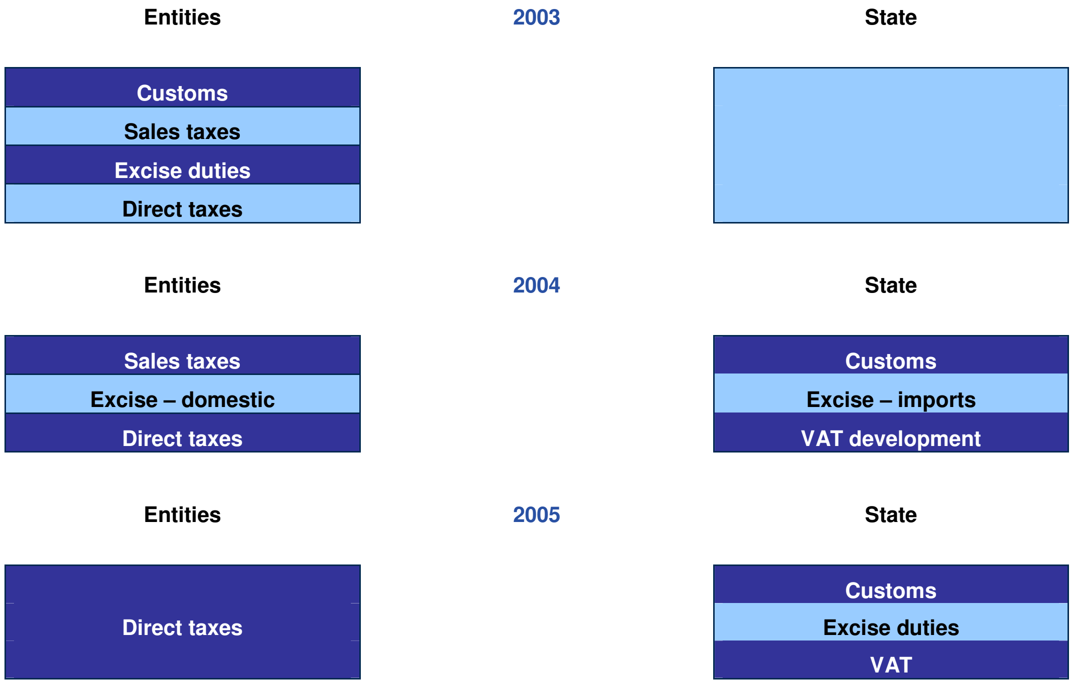
### 7.2.3 Achievements and challenges

The main breakthrough is considered to be the establishment of the Indirect Tax Authority in 2003. This represented the first major effort involving a substantial transfer of fiscal sovereignty from the Entities to the State. The entire set-up of the state-level control of customs administration and indirect taxes has been driven by the entire international community.

Starting with the 'Decision on the Law on the State Border Service' of January 2000, a series of decisions from the High Representative setting up state-level institutions and laws followed. These included major changes in the existing customs law in 2000, setting up the ITA in 2003 and 2004, and enacting and amending indirect tax laws (including timing, cooperation and personnel) in 2004 and 2005. The conditions in the MoU and SMoU are to be considered as steps in this process. Interviewees confirmed that CAFAO has been very instrumental in the customs and tax administration reform by providing sustained technical assistance over a long period of time.

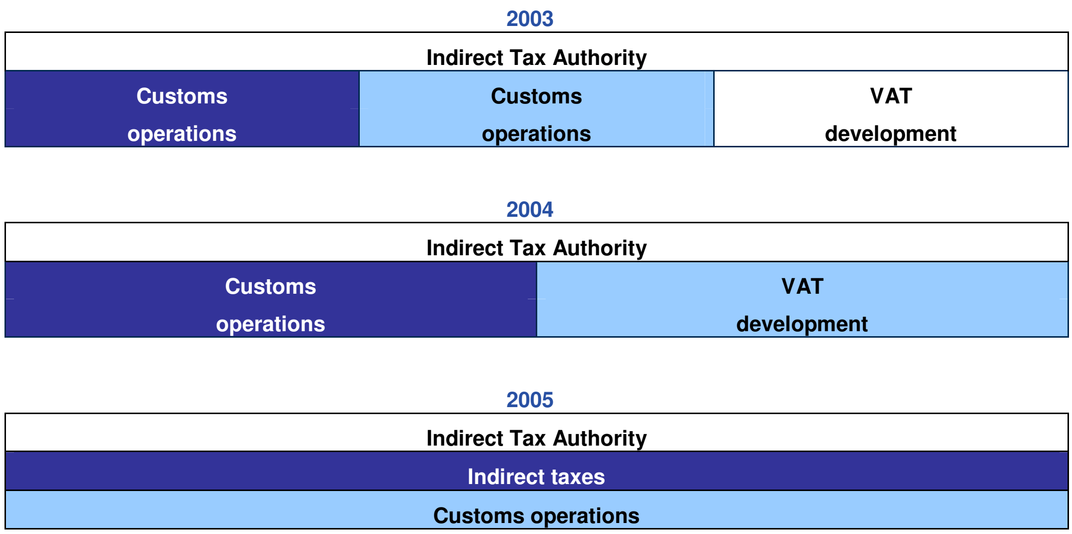
Establishing the ITA is considered to have been a difficult process, but a very successful one. It has taken place in stages. Tax responsibilities have gradually been shifted from entity level to state level. In 2003, customs duties, sales taxes, excise duties and direct taxes were still being collected by the Entities. By 2005, the state-level ITA was collecting customs duties, excise duties and VAT. The Entities have remained responsible for direct taxation (see Figure 7.1).

Figure 7.1 Division of tax responsibilities 2003, 2004 and 2005




The structure of the ITA has also changed over time. In 2004, there were still separate structures for customs operations in each Entity and for VAT development. By 2006, customs and VAT were integrated in one structure covering indirect taxes (see Figure 7.2).

Figure 7.2 Organisation of the Indirect Tax Authority 2003, 2004 and 2005



The main achievements so far in the area of customs and indirect taxes have been:
- customs legislation and procedures based on EU principles applied throughout BiH;
- entity-level laws on indirect taxation harmonised;
- customs processes fully computerised;
- customs and tax fraud uncovered and reduced;
- an increase in customs and tax revenue.

Many interviewees considered establishment of the ITA and the introduction of VAT as the most successful reforms in the country. The introduction of VAT has contributed to reducing the 'grey' economy and has supported the creation of Bosnia and Herzegovina as *a single economic space*.

While the introduction of VAT has been successful, there has still been little progress on a stable system for reallocation of indirect tax revenue. Almost every one to two months debates on allocation flare up. This is hindering the ITA board from spending more time on efficient tax collection issues.

The strengthening of tax administration needs to be continued. Interviewees made frequent comments on the way in which tax collectors verify tax forms, more by looking to see if taxpayers have ticked the box of the Entity rather than paying more attention to those who still evade their tax obligations.

Some interviewees stated that the main *carrot* has been the SAP and the possibility of gaining future EU membership. The MFA conditionalities have provided additional support for the reforms, especially by restating and politically reinforcing their importance on behalf of all international and bilateral donors to Bosnia and Herzegovina in general (which all strongly pushed for these reforms), and the EC in particular towards the state level and Entity Governments.

## 7.3 Privatisation of strategic enterprises

### 7.3.1 Legal framework

In line with the General Framework Agreement for Peace in Bosnia and Herzegovina (the Dayton Agreement), the Framework Law on Enterprise and Bank Privatisation in BiH recognises the Entities' rights in the design of the privatisation process for state-owned enterprises located in their territories. Each Entity has its own privatisation laws that regulate the privatisation procedures.

The process of privatisation of state capital in companies in the FBiH is being implemented within the framework of the Law on Privatisation of Enterprises. Based on this law, privatisation falls under the competence of the cantonal governments. Each of the 11 cantons comprising the Federation has its own privatisation agency established according to its own legislation. In addition to the cantonal privatisation agencies there is the Federal Privatisation Agency (FPA). The FPA is not superior to the cantonal agencies. Instead, its task is to provide advisory assistance to the cantonal privatisation agencies and coordinate their work.

Within the RS, the privatisation process is being implemented under the Law on Privatisation of State Capital in Enterprises. Compared with the FPA, the Privatisation Agency of Republika Srpska has greater powers, as there are no regional privatisation agencies.

### 7.3.2 EC assessment of the conditionality

The MoU included the following conditionality for disbursement of the second tranche:

*'Upon advice of the IAUP, the RS Government will submit to Parliament a proposal to revoke those amendments to the Law on Privatisation recently adopted by RSNA, which obstruct the privatisation process. The Federation will have offered for sale at least four additional companies from the list of 56 strategic enterprises.'*

The MoU conditionality was assessed by an EC mission that visited Bosnia and Herzegovina in the period 2-6 June 2003. The mission reported as follows:

*'An amended Privatisation Law, revoking earlier amendments, was approved by the RS Government on the 8th April and was to be sent to the RS Parliament (RSNA) under the urgency procedure later that week. This has been finally sent on 29 April (hence fulfilling our condition), with further (apparently positive) changes adopted by the Government in the meantime. In the Federation, since November, seven additional companies have been offered for sale from the EU allocation from the list of 56 strategic enterprises, although no new contracts have been issued. This condition has been fully met. At the time of the June mission, the status of the privatisation process is the following: in the FBiH, 15 companies out of 56 have been privatised, while in the RS only four companies out of 80 have been privatised. Given the importance of speeding up the privatisation process of strategic enterprises for BiH, the draft SMoU continues to have conditionality on offering for sale a certain number of strategic enterprises in both Entities.'*

The Supplementary MoU included the following conditionality for disbursement of the third tranche:

*'The Republika Srpska will offer for sale at least six additional companies from the list of 80 strategic enterprises. The Federation will offer for sale at least another eight additional companies from the list of 56 strategic enterprises.'*

The conditionality in the Supplementary MoU was assessed by an EC mission that visited Bosnia and Herzegovina in the period 14-17 June 2004. Their review of the SMoU third tranche conditionalities was as follows:

*'Privatisation of strategic enterprises has continued both in the Federation and in the RS. In the RS, tenders are ongoing for seven companies from the list of 80 strategic enterprises referred to in the SMoU. In the Federation, eight companies from the relevant list of 56 strategic enterprises have been sold since January 2004. Both Entities have therefore achieved their targets and the condition is met.'*

### 7.3.3 Review of actual developments in the domain of privatisation

*A. Progress in the Federation of BiH*

The FBiH law on privatisation distinguishes between privatisation of enterprises with fewer than 50 employees and total capital value of less than 500,000 KM (small-scale privatisation) and enterprises with a total capital value of above 500,000 KM (large-scale privatisation). Table 7.1 shows the development of the number of privatised companies since 1999.

**Table 7.1 Percentage of privatised companies since 1999**

| Description | 1998-2000 | 2001-2003 | 2004-2006 | Total |
|---|---|---|---|---|
| Privatised firms (%) | 14.3 | 68.2 | 72.5 | 145 |
| Privatised assets (%) | 4.8 | 37.3 | 39.6 | 476 |
| | | | | |

Source: FBiH Privatisation Agency

It can be seen that considerable progress in privatisation was achieved during the early period of privatisation (1999-2003). Almost 70% of the total number of state-owned firms was privatised by the end of this period. The percentage of privatised assets is significantly lower, however, which indicates that the privatisation process has been primarily concerned with small enterprises. It can be further observed that the privatisation process has stagnated from 2004 onwards.

Stagnation of the privatisation process is demonstrated by progress in the privatisation of strategic enterprises. From the list of 56 strategic enterprises 22 have been sold so far,[20] so around 40% of them have been privatised. However, in terms of privatised assets, progress has been more limited. The strategic enterprises that have been privatised represent only 8.9% of the total value of state capital in the list of 56 strategic enterprises. As the EU mission's report on 15 privatisations to June 2004 notes, only seven strategic enterprises have been privatised during the last 2.5 years.

According to the FBiH Privatisation Agency, a number of obstacles restrain progress in privatisation. Among others, the following factors are most frequently mentioned:
- lack of political will, reflecting low public trust in the benefits of privatisation;
- an overly decentralised institutional framework for managing the privatisation process;
- an inadequate privatisation model that attempts to resolve outstanding state liabilities towards citizens;
- overvalued corporate book values, large outstanding corporate debts and arrears.

An exemplar of the cumbersome process of privatisation within the FBiH is the case of Energopetrol, which owns and operates 64 filling stations in Bosnia and Herzegovina. In June 2005, the FBiH set up a committee to develop the conditions for tendering. After

[20] This figure is based on the FPA list in Bosnian. The FPA list in English shows only 10 sales. As the English list has omitted some cases of privatised enterprises, the Bosnian list is used for the analysis. In the further course of the evaluation, specific attention will be paid to retrieving the correct numbers.

tendering, a consortium consisting of Hungarian oil and gas company MOL and the Croatian oil company INA was selected in September 2005. The offer was supported by Energopetrol employees, as illustrated by the trade unions' consent. However, since then, *'nothing but political interference has been observed'* (as mentioned by one interviewee). Only in September 2006 was the contract with the Government of Bosnia and Herzegovina signed. Completion of the transaction is still subject to several conditions, among them being the approval of the Competition Council. At the time of the evaluation team's mission to Bosnia, the Competition Council had not finalised its decision. Such delay in decision-making may suggest further political interference.

### *B. Progress in Republika Srpska*

The RS law on privatisation distinguishes between privatisation of enterprises with fewer than 50 employees and total capital value of less than 300,000 KM (small-scale privatisation) and enterprises with a total capital value of over 300,000 KM (large-scale privatisation). The latter category encompasses both strategic and non-strategic enterprises.

Table 7.2 shows the development of the number of privatised companies since 1999. It can be seen that 58 strategic enterprises have been privatised. However, the precise assessment of the MFA conditionality remains problematic as the original list of 80 strategic enterprises in the RS referred to in the conditionality could not be replicated by the RS Privatisation Agency. The agency's operational list of strategic enterprises includes 164 enterprises.

**Table 7.2 Number of companies privatised since 1999**

| Description | 1999-2001 | 2002-2004 | 2005-2006 | Total |
|---|---|---|---|---|
| Small-scale enterprises | 115 | 25 | 5 | 145 |
| Large-scale enterprises, non-strategic | 84 | 336 | 56 | 476 |
| Large-scale enterprises, strategic | 2 | 41 | 15 | 58 |
| Total | 201 | 402 | 76 | 679 |

Source: RS Privatisation Agency

The development of privatisation in terms of state capital lags behind privatisation in terms of companies, indicating that privatisation has so far focused on smaller companies. Table 7.3 shows that the RS Government has retained around 40% of former state capital. Nevertheless, progress in the RS is well above that in the FBiH, which has retained 60% of its stock of state capital.

**Table 7.3 Development of state capital 1999-2006**

| Description | KM | % share |
|---|---|---|
| State capital as at 30 June 1998 | 8,277,248,370 | 100 |
| Total state capital privatised (Nov 2006) | 4,983,293,087 | 60.2 |
| State capital not privatised | 3,293,955,283 | 39.8 |
| | | |

Source: RS Privatisation Agency

The RS Government's commitment to the privatisation process is illustrated by the recent sale of Telekom Srpska, which is the largest company in the Republika Srpska. After the closure of the tender in November 2006, it was sold to Telekom Srbija in December 2006.

### 7.3.4 Causal link between MFA and progress on privatisation

The net impact of MFA on the development of the privatisation process is not considered to be substantial. This assessment is based on the following findings:

- Officials of the privatisation agencies appeared not to be acquainted with the MFA assistance and its conditionality on the privatisation of strategic enterprises. Apparently, the Bosnian authorities did not communicate the conditionality to those in charge of realising it. This implies either lack of interest among the Bosnian authorities in realising the conditionality, or that the conditionality was in line with prevailing work programmes, so that no additional pressure on the privatisation agencies was deemed necessary by the Bosnian authorities.

- The stagnation of progress in privatisation in the Federation after 2003 coincided with the period during which MFA support was granted. This implies that MFA was not successful in stimulating the privatisation process. This argument is specific to the FBiH as the privatisation process in the RS has continued.

- The Director of the Privatisation Agency mentioned only the World Bank's technical assistance instrument (PTAC) as supportive of his operations.

- Until 2004, the privatisation process in the FBiH was supported by the so-called International Assistance Group for Privatisation (IAGP). Within the IAGP, the role of the EU was shared with the United States Agency for International Development (USAID), the World Bank Resident Mission in BiH and GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit). The role of EU support in this programme was primarily to provide technical assistance, and as such it was unrelated to the MFA. This finding indicates that MFA was one among other instruments of the international community in stimulating progress in privatisation.

- After 2004, the World Bank negotiated a corporate restructuring credit with the FBiH authorities. This credit was designed as a development policy loan (DPL) that would only be disbursed after realisation of the conditionality. Since the Bosnian authorities did not meet the conditions attached to the credit, it has not been disbursed (consequently, the DPL has not been externally published). This finding indicates that the link between financial support and progress in privatisation is weak.

### 7.3.5 Conclusions

Three conclusions can be drawn from the case study on privatisation. First, it shows that the EU has rightly assessed the MFA conditionality on large-scale privatisation as having been met. Secondly, the realisation of this conditionality has not resulted in unambiguous further structural progress on the issue of privatisation. Institutional conditions, such as the authority of the Privatisation Agency and the political decision-making structure, appear to be more important explanatory factors in the development of privatisation, as can be concluded from the divergent performance of the RS and FBiH Governments. Thirdly, the inclusion of the MFA conditionality appears not to have influenced progress in privatisation. External financial incentives have played only a minor role in the complex institutional setting in which privatisation has taken and is still taking place.

# 8 Implications of the design and implementation of the operation

## 8.1 Introduction

This chapter reviews the consequences of the design and implementation of MFA in Bosnia and Herzegovina on the operation's performance. It therefore addresses the following evaluation question (Table 8.1).

**Table 8.1 Relevant evaluation question concerning the implications of design and implementation**

| | Impact of structural reforms |
|---|---|
| Q5.1 | In what way has the design and implementation of the MFA conditioned the performance of the MFA operation in respect to its cost and its objectives? |
| | |

The chapter ends with general conclusions and recommendations that will contribute to a future meta-evaluation of several MFA operations, with a view to deriving strategic lessons about the MFA instrument.

## 8.2 Main findings

*Q5.1 In what way has the design and implementation of the MFA conditioned the performance of the MFA operation in respect to its cost and its objectives?*

*Implementation delays*
The MFA operation in BiH was affected by delays in implementation compared with the original expectations. As shown in Chapter 4, this affected its possible effectiveness in terms of macroeconomic stabilisation. In one interviewee's words, *'what was supposed to be a one-year operation turned out to be a three-year exercise'*. This partly reflected the BiH Government's difficulties in fulfilling conditionalities, but was also as a result of a series of exceptional operational difficulties with both the EU and BiH legal environments. These can be broadly summarised as follows:

- the need to have the MFA loan component approved separately by the Parliaments of the two Entities, as the BiH State as such was not legally entitled to borrow until recently. The exercise also had to be repeated separately for each addendum to the original agreement;
- the complex preparation of legal opinions in the difficult BiH legal environment;

- the Operational Assessment made necessary by the new EU financial regulation which had come into force in the meantime. This has now become part of the preparatory phase of each MFA, but in the case of BiH this exceptional event (which could not be anticipated in advance) amounted *de facto* to an additional conditionality.

Each of these steps can be broadly estimated to have caused a notable delay compared with the anticipated disbursement schedule, and two of them (namely parliamentary approval and legal opinions) had to be repeated.

One unexpected consequence of these delays was a misaligned phasing of actual MFA disbursements with the evolution of IMF assistance in the country, and a related misunderstanding of its possible political significance. The last tranche of MFA was disbursed when there was no IMF SBA in place, as the one to which MFA was originally related had already been completed. This occurred at a time when, while a financing gap reportedly was still estimated, negotiations for a new SBA were stalling because of policy disagreements between the IMF and the BiH state-level and entity-level Governments on related conditions.

There were diverging opinions on the impact this misalignment could have had on the public and the BiH Governments:
- A large majority of respondents maintained that it would have been simply too unfair and unpopular not to disburse the MFA’s last tranche just because of implementation delays, as the country had substantially fulfilled its conditions and successfully completed its previous SBA.
- One interviewee maintained that the unlucky timing of this decision could have inadvertently weakened the IMF’s negotiating position. This was because the public could have gained the impression of a disagreement between the IFIs and the EU, especially at a time when – quite coincidentally – the World Bank had also suspended its structural lending disbursements. To add to this possibility, the EU Delegation routinely issued press releases every time MFA funds were released, which at that time contrasted in the media with news concerning the difficult negotiations with the IMF.

Nobody questioned the appropriateness of the decision per se or its legal validity. It was simply noted how implementation problems caused delays in timing, possibly interfering with subsequent IMF negotiations.

The exceptional need to have a budgetary Operational Assessment resulted in a negligible marginal increase in the overall cost of the MFA.

*Lack of reference to a domestic reform programme document*

Regarding genuine ownership of proposed reforms, a critical aspect in the case of BiH (as shown in Chapter 6) was that the MFA was not able to refer to any internal government reform programme as a basis for its proposed structural reforms. The simple reason for this was that such a document should have been prepared at state level and shared by the two Entities. As a consequence, no reference could be made to official BiH government policy statements as proof of local ownership. Further to this, the MFA included conditionalities aimed at progressively incorporating EU standards and norms and therefore implicitly considered approximation to the EU *acquis* to be part of the agenda. As such the country did not need to show explicitly strong ownership as implicitly this was increasingly incorporated in the steps made forward by the country with the SAP.

*Fragmented allocation of funds resulting in insufficient incentive*

A peculiar and country-specific aspect of the BiH operation was the distribution of funds among the various actors involved. As the State Government was not legally allowed to borrow, the loan component had to be distributed to the two Entities, based roughly on the two-thirds FBiH/one-third RS constitutional-type provision.[21] The grant component was shared between the State Government (40%) and the two Entities (60%). The Entities' share was split according to the usual two-thirds/one-third ratio. In terms of the net contribution of external financial assistance in catalysing reforms and building consensus on their implementation modalities, according to some interviewees the fragmented allocation of financing among the different Governments somehow weakened the incentive to really implement structural reforms. This was because the reform burden was carried comparatively more by the Entities Governments, which received a relatively small amount of support in exchange. This appeared to apply particularly to the Republika Srpska, which received some € 14 million, half of it on reportedly *'commercial lending terms'* and apparently a *'marginal amount of money to be of incentive for any reform',* as mentioned by one interviewee. At any rate, it must be borne in mind that the MFA included a number of conditionalities related to institution-building and the *acquis*, mainly to be implemented or coordinated at state level.

*The overwhelming appeal of the grant component and budgetary support*

The grant component of MFA in BiH represented a decisive, though extraordinary, incentive. This was because, unlike typical TA, the MFA was perceived as horizontal budgetary support *'benefiting to all, and not only to a given department or unit within Government'*. By contrast, the loan was often – though erroneously – perceived as having been provided *'on commercial terms'* by BIH counterparts apparently unaware of any potential credit constraints on them. On top of that, as mentioned before, the practical appeal of the grant was also increased by the comparison with the complex loan approval procedure: *'without the loan the whole process would have been more streamlined and more effective'*.

The highly positive appreciation of budgetary support, especially for investment purposes, extended to traditional TA instruments. For instance, some interviewees considered that future Instrument for Pre-Accession (IPA) support should include some kind of budgetary support facility, especially for investment purposes, because TA money is bound to be *'easily wasted in a number of preparatory initiatives in a country that has a limited TA absorption capacity'*. However, there was also a certain underestimation of the complexities of having monitorable budgetary procedures in place that would make dedicated budgetary support possible.

[21] The Republika Srpska share is actually slightly less than one-third, as 4% is traditionally allocated to the Brcko District.

*Assessing the costs of structural reforms and designing financial incentives accordingly*
In much the same vein, some respondents remarked how the allocation of funding to the both entities and therefore to the various policy areas was too disproportionate to their anticipated budgetary costs to represent a real incentive to agree on implementation modalities. In other words, while the representatives of the EU and the international community cared about broad financing gap and policy issues, some of their BiH counterparts seemed to assess the appropriateness of proposed financing by mentally summing up the cost and budgetary consequences of proposed reforms in each policy area. This led some to formulate vague and generic suggestions on the need to streamline future MFA design by *'better tailoring financial incentives to requested reform effort',* or *'adapting allocation to Entities to specific difficulties of reform ahead'*.

In the BiH context, such estimations can also be understood as an additional negotiation tool to agree on internal allocation of resources. It is worth noting how these comments were one more instance of the different perceptions of the MFA instrument by IFI and EC officials and Bosnian officials. The former assumed that MFA was a BoP and budgetary support instrument. As such, they did not see a particular need to estimate the cost of proposed reforms, deeming the matter as broadly irrelevant or unnecessarily complex for an emergency instrument. The latter, meanwhile, often seemed more naturally inclined to link received financing as a leverage instrument to foster proposed reforms, also in very specific budgetary terms.

*Internal publicity of the reform agenda*
As far as operational synergies with other EU or IFI programmes are concerned, it was noted that MFA was assigned based on the somewhat implicit presumption that the Government would inform all its branches about the agreed policy reform agenda, so that they could respond accordingly. While this coordination and information sharing certainly existed at the political Council of Ministers or Ministry of Finance level, communication mechanisms further down the hierarchical chain were not so obvious. Instances were found of top civil servants who were poorly informed about MFA and its link with the activities under their area of responsibility. In some cases their regret was that if they had known, they could have used the information to more effectively lobby for resources within the Government or synergic TA from the donor community. In the case of BiH, it appears that making the various Ministries of Finance responsible for monitoring did not necessarily result in creating effective communication channels with all the institutions involved.

*No bias induced by subsequent monitoring needs*
Given the limited availability of data and reliable statistics in BiH, no evidence could be found that possible practical difficulties in monitoring conditions of a quantitative nature played any role in the actual identification of EU conditionalities. In this particular context, the conditionalities had to be of a qualitative nature almost by definition. Monitoring of MFA in BiH proved quite difficult, especially in its early phases, mainly because of the lack of secondary sources and the need to consolidate primary data from the two Entities. Many interviewees agreed that the Governments in BiH at the beginning were inadequately equipped and totally lacked experience to cope with the task. In one respondent's view, MFA monitoring would have been unnecessarily frequent in BiH, where reforms do not take place so quickly (*'nothing substantial happens here in a three-*

*month period')*. Requiring quarterly reports and a biannual reporting mechanism would have been much more appropriate for the country and less costly to implement.

*The wide agenda of conditionalities and their reinforcing effect*
When it comes to the strategic synergies between the MFA and other EU and IFI programmes in achieving structural reforms, an often neglected aspect is the overall scale of the proposed reform agenda. It is broadly estimated that, in the period concerned, the overall policy reform agenda of the Governments in BiH included as many as 100 to 150 structural conditionalities from various sources, including the IMF, different World Bank operations and the EU MFA. The sheer size of this figure represents a reform programme that was somewhat ambitious and fairly wide in scope. To many interviewees this pointed to the need to (i) simplify and (ii) better tailor conditions in the light of a realistic assessment of both willingness and local capacity to implement.

If the full picture of conditionalities is not taken into consideration it would be too easy to overestimate the chances of success and include irrelevant technicalities. This could ultimately result in the beneficiary government possibly shopping around the conditions it likes the most to the detriment of real priorities. This argument favours simplifying conditions and possibly streamlining and grouping them. However, on the practitioners' side there appeared to be – especially among IFIs – a strong view that too much reinforcing of conditionalities should be avoided in the BIH context out of purely practical concerns. It would be extremely difficult, according to some interviewees, to devise a coordinated monitoring mechanism. Each IFI would end up making the same requests to different government institutions on the very same subjects.

*Uneven progress in implementing reforms in the Entities and conditions aimed at state-level consolidation/coordination*
In terms of the appropriateness of multiple strategic objectives within the same MFA instrument, it was generally acknowledged that MFA would have had the additional objective in BiH of supporting the establishment of institutions at state level, also as a way to prepare for the *acquis*. It was also of little surprise that in a number of cases the bulk of resistance to transferring policy responsibilities to state-level institutions as part of nationwide state building was found in the Republika Srpska. This resistance was variously motivated on the grounds of lack of compliance with Dayton agreements, concerns about the perceived (in)efficiency of spending at state level, and other operational inefficiencies. Admittedly, when it came to assessing arguments against the transfer of competences to state level it was difficult to distinguish between such genuinely rational arguments and more politically oriented ones.

*Further strengthening of the prior action concept*
MFA is generally devised with relatively easy structural conditions linked to the *first* tranche in order to allow rapid disbursement of funds, thereby postponing more difficult conditions to the later implementation phases. Some interviewees maintained – based mainly on the World Bank's unsuccessful experience with structural adjustment loans in the country – that the prior action concept should be further strengthened in BiH. For instance, the World Bank reportedly is increasingly considering extensive recourse to prior actions that should be met before a loan is submitted for board approval. This would avoid the dilemma between not fulfilling the BiH Governments' expectations of receiving

grant-type support after a long monitoring and approval/implementation process (as was also the case with MFA) by committing funds that are not ultimately spent *and* the need not to be too soft in assessing fulfilment of conditionalities. The concrete applicability of this approach to the BiH context remains to be seen. However, it would hardly be compatible with an MFA instrument, which however locally perceived as being related to structural adjustment, officially remains a balance of payment/budget support instrument to be used in emergency situations.

## 8.3 Conclusions and recommendations

Based on our analysis and interpretation of the MFA operation in Bosnia and Herzegovina, and in the light of previous evaluation results, we have drawn the following conclusions on the performance of MFA. For each conclusion, we include our recommendations for addressing identified weaknesses and/or reinforcing the strengths of MFA. These general conclusions and recommendations should also contribute to a future meta-evaluation of several MFA operations, with a view to deriving more strategic lessons about the instrument.

1. *MFA objective*: In general, Council Decisions concerning MFA state the objectives of providing the assistance. In these Decisions, Article 1 uses the wording *'with a view to ensuring a sustainable balance of payments situation'*. The Council Decision and subsequent grant and loan agreements mention ensuring a sustainable balance of payments situation as the main objective of MFA, together with easing financial constraints and support for the implementation of structural reforms. However, in the case of BiH there were additional objectives, never clearly specified or made explicit, related to strengthening state-level institutions or gradually preparing for incorporation of the EU *acquis*.

   This might seem perfectly logical from the point of view of the EC agenda. However, selectivity in choosing only conditions directly critical to achieving the main objective, along with lack of interference with the internal consensus-building process, should remain the driving force in designing conditionalities. MFA appears to be an improper and exceedingly weak instrument to achieve the EU's political objectives such as support for state building for internal market purposes. These matters are more appropriately dealt with within the accession process. *The design of the instrument for balance of payment purposes should stick to a few critical conditions where sufficient horizontal consensus exists in the country.*

2. *Timeliness of disbursement*: The rationale for an MFA intervention is the need to fill a foreseen residual financing gap, an objective normally requiring timely and speedy action. By contrast, most structural issues require more time. Addressing structural issues through MFA should normally be given secondary importance. For a number of MFA conditions in BiH, only an indirect and qualitative link could be established between the possible effects of fulfilling the conditions and the balance of payments. Some conditions could only realistically be attained over a medium-term period and thus did not address the short-term financing need. Furthermore, the implementation of MFA in BiH was marred by bureaucratic and procedural delays, mostly of an

exceptional nature or linked to constitutional procedures in the country. While it can be argued that these structural conditions could have been considered as instruments to enhance macroeconomic stability, the timing of (possible) fulfilment appeared not to be aligned to pressing short-run needs.

*We therefore suggest primarily including conditions that have direct or indirect – but measurable – links with the core issue of MFA, i.e. filling a foreseen residual financing gap. We would also recommend that in complex legal environments the Commission should anticipate as early as possible in the preparation phase not only the Operational Assessment, as is currently being done, but also any other legal due diligence activity.*

3. *Number of conditions*: In the period concerned, Bosnia and Herzegovina faced around 100 to 150 different conditionalities for the various programmes of the international community. This would have been an impossible agenda for any government to implement. Under such circumstances, a less ambitious and more focused approach with a limited number of structural MFA conditions should have been considered. *In each instance it would be worth asking whether a given condition substantially contributes to realising the main objective of the programme.* Otherwise, its inclusion either sends a confusing signal about the true objectives, or overburdens the recipient government with non-essential conditions. *Such a test of 'criticality' should be performed in a disciplined manner, with preference given to parsimony of conditions.* Adding non-critical conditions increases the risk of unjustified delay in the intervention, which may work against the goal of easing external financial constraints.

4. *Composition of MFA*: The relatively large grant component of MFA in BiH softened the average terms of MFA and the whole support package to the country. Depending on a country's circumstances, softening the terms of MFA can be a meaningful signal to the government and at the same time can ease the burden of the original support package to the country. The exceptional weight given to the grant component in the BiH operation was fully justified by local conditions. It can be seen as an appropriate feature of the MFA operation in the country, despite its relatively high cost. A less costly design for the instrument would have negatively impacted on incentives to reform and ultimately reduced the overall effectiveness of the MFA. *So it is recommended that the Commission should continue considering having recourse to a grant option in exceptional cases of complex operations in International Development Association (IDA) countries.*

5. *Political ownership:* ownership of reform is universally recognised as the key determinant of compliance with programme conditionality. The recent *Joint evaluation of general budget support*[22] concludes that conditionality usually creates managerial, not political pressure. It focuses on the *when* and *how* and not on the *what* of reforms. If conditionality works, it helps to maintain the pace of reforms. It does not create the (political) will to implement them. However, the existence of an internal blueprint for economic reform does not guarantee ownership of the

[22] *Evaluation of general budget support: synthesis report*, May 2006, available at http://www.oecd.org

underlying programme. Two factors are to be considered to understand the sense of country ownership in the BiH context. Since BiH is a potential candidate country at some stage it will need to comply with all the *acquis* requirements. The BiH authorities will have to go through the SAP process and effective implementation of a Stabilisation and Association Agreement is a prerequisite for any further assessment by the EU of the country's prospects of accession. As such the country did not need to show explicitly strong ownership as implicitly this was gradually incorporated in the steps made forward by the country with SAP.

In addition Bosnia and Herzegovina did not need to express explicitly and extensively country ownership due to the strong role and mandate of the OHR and the wide-ranging involvement of the international community.

*Nonetheless, to facilitate good implementation of conditions under MFA the Commission should continue to consider the drafting of structural conditions with reference to genuinely owned programmes as best practice and their existence, whenever possible, a precondition showing that some debate has taken place within government.*

6. *Communication aspects:* Given the EC's role within the donor community, the link between MFA and the IMF Stand-by Arrangement was not always well understood. This may have given rise to misunderstandings, particularly when MFA had not yet completed disbursements and the IMF was facing difficulties in negotiating a new SBA. Furthermore, the limited administrative capacity often available in MFA recipient countries tends to be neglected, especially as far as internal communication aspects are concerned. *It is recommended that EU Delegations and EC headquarters should more closely coordinate their communication campaigns for MFA to avoid misunderstandings about its possible political significance.* Moreover, although domestic dissemination of information about MFA clauses should largely remain a counterpart government responsibility, *the Commission should find ways to ensure that minimum communication requirements are enshrined in MFA design. This is in order to ensure that agencies involved in implementing conditionalities are fully aware of MFA's existence.*

7. *Flexibility:* There is a tendency among beneficiary countries to regard MFA mainly as a budgetary support instrument to achieve mid-term structural reform objectives. This leads to criticism of the way in which the implications of the instrument are costed, the burdensomeness of the monitoring procedure, and the more extensive recourse to prior actions. It needs repeating that the rationale for an MFA intervention is to fill an external financing gap and to reduce short-term macroeconomic imbalances, and that flexibility is therefore important. *If MFA has to remain a truly emergency instrument, it is not advisable to carry out a complex assessment of structural reform costs, as this would unduly lengthen the negotiation process. Such a procedure would be recommendable for mid-term budgetary support instruments with structural reform objectives.*

   In much the same vein, *frequent quarterly monitoring of implementation should still be considered fully justified.* Longer monitoring periods of annual or biannual length are more appropriate for instruments that are oriented purely to structural reform, and horizontal budgetary support.

Finally, *the design of MFA should remain unbiased by excessive recourse to prior actions or conditions to be fulfilled for disbursement of the first tranche*, apart from those related to the OA, which can be considered as a kind of legal pre-requirement. Such design techniques appear more appropriate for instruments oriented purely to structural reform and horizontal budgetary support.

# Annexes

Annex 1: Delphi evaluation questionnaire
Annex 2: Overview of synergies with MFA conditionalities
Annex 3: Delphi tables of international respondents
Annex 4: References
Annex 5: Key people involved in the MFA operation
Annex 6: People interviewed

# Annex 1: Delphi evaluation questionnaire

Please return it duly filled to Ferry Philipsen, email: ferry.philipsen@ecorys.com
Thank you for your kind cooperation.

**Macroeconomic Part**

1) How do you assess the current overall macroeconomic stability of Bosnia in comparison with the situation in mid-2002 ?

| Worsened | The same | A bit better | Much better | Don't know |
|---|---|---|---|---|
| | | | | |

Why ?

---

2) What was the role played by external macroeconomic assistance in the period (IMF, MFA, WB structural loan, EIB) in this stabilisation process, if any ?

| Worsened things | No real role | A minor role | A substantial role | Don't know |
|---|---|---|---|---|
| | | | | |

Why ?

---

3) How do you assess the importance of EU MFA contribution to the stabilisation process as compared to other institutions or means ? (roughly in % weight terms)

| | |
|---|---|
| Natural dynamics / Natural evolution of economic conditions | …% |
| External macroeconomic assistance overall of which | …% |
| *IMF* | *….%* |
| *WB (structural adjustment loans)* | *….%* |
| *MFA* | *….%* |
| *Other ………………….. (specify)* | *….%* |
| **TOTAL** | **100%** |

4) How could have MFA role been enhanced (please score 0 for no enhancement x for minor possible enhancement, xx for enhancement, xxx for strong enhancement)

| | |
|---|---|
| More timely delivery | |
| Larger grant component | |
| Other ………. …………………..specify | |

5) Imagine you were in 2002 and consider the situation as it was at that time. What would have happened if the MFA had not existed ?

| | Very unlikely | Unlikely | Likely | Very Likely | Don't know |
|---|---|---|---|---|---|
| **IMF** | | | | | |
| Larger programmes | | | | | |
| Tighter policy conditions | | | | | |
| Laxer policy conditions | | | | | |
| No reaction | | | | | |
| **EU** | | | | | |
| Switch money from TA | | | | | |
| No reaction | | | | | |
| **World Bank** | | | | | |
| Increase structural lending | | | | | |
| Tighter policy conditions | | | | | |
| Laxer policy conditions | | | | | |
| No reaction | | | | | |
| **Other donors** | | | | | |
| Increase lending | | | | | |
| Switch money from TA | | | | | |
| More debt cancellation | | | | | |
| **Bosnian Government** | | | | | |
| More taxes | | | | | |
| Less public spending | | | | | |
| More borrowing | | | | | |
| No reaction | | | | | |

6) Please elaborate on the macroeconomic, balance of payments and fiscal consequences of your more likely scenario in the light of existing constraints (currency board, etc….)

7) What is the likelihood (in terms of rough % chance) of a financial crisis you have attached to Bosnia in the following years?

| 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| % | % | % | % | % |

**Structural Reform Part**

8) How do you assess the importance of proposing the following structural reforms in the Bosnian policy agenda at that time ?

| | Inappropriate priority | Minor issue | Important issue | Key priority | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | | | | |
| Customs and indirect tax reform | | | | | |
| Public procurement | | | | | |
| Bank privatisation | | | | | |
| Banking supervision | | | | | |
| Deposit insurance | | | | | |
| Insurance supervision | | | | | |
| Implementation of bankruptcy law | | | | | |
| Large scale privatisation | | | | | |
| Competition policy | | | | | |
| Phytosanitary standards | | | | | |
| Meat and animal product standards | | | | | |
| Statistical harmonisation of industrial production data | | | | | |

With the benefit of hindsight, would you have proposed other priorities for structural reform ? If so which ones ?

9) How do you assess progress achieved in the following policy areas in comparison with the situation in mid-2002 ?

| | Worsened | The same | A bit better | Much better | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | | | | |
| Customs and indirect tax reform | | | | | |
| Public procurement | | | | | |
| Bank privatisation | | | | | |
| Banking supervision | | | | | |
| Deposit insurance | | | | | |
| Insurance supervision | | | | | |
| Implementation of bankruptcy law | | | | | |
| Large scale privatisation | | | | | |
| Competition policy | | | | | |
| Phytosanitary standards | | | | | |

| | Worsened | The same | A bit better | Much better | Don't know |
|---|---|---|---|---|---|
| Meat and animal product standards | | | | | |
| Statistical harmonisation of industrial production data | | | | | |

## 10) Whenever progress was achieved what was in your opinion the relative weight in rough percentage terms of the incentive provided by external influence factors?

| | IMF | EU MFA | World Bank | EU SAA CARDS | Would have been already in the agenda at any rate | TOTAL |
|---|---|---|---|---|---|---|
| Application of the treasury system | | | | | | 100% |
| Customs and indirect tax reform | | | | | | 100% |
| Public procurement | | | | | | 100% |
| Bank privatisation | | | | | | 100% |
| Banking supervision | | | | | | 100% |
| Deposit insurance | | | | | | 100% |
| Insurance supervision | | | | | | |
| Implementation of bankruptcy law | | | | | | 100% |
| Large scale privatisation | | | | | | 100% |
| Competition policy | | | | | | 100% |
| Phytosanitary standards | | | | | | 100% |
| Meat and animal product standards | | | | | | 100% |
| Statistical harmonisation of industrial production data | | | | | | 100% |

## 11) What, if any, was MFA contribution to conditionality fulfilment (cross X when relevant) ?

| | Speeded up delivery | Shaped contents of reforms | Other (please specify) |
|---|---|---|---|
| Application of the treasury system | | | |
| Customs and indirect tax reform | | | |
| Public procurement | | | |
| Bank privatisation | | | |
| Banking supervision | | | |
| Deposit insurance | | | |
| Insurance supervision | | | |
| Implementation of bankruptcy law | | | |
| Large scale privatisation | | | |
| Competition policy | | | |
| Phytosanitary standards | | | |
| Meat and animal product standards | | | |
| Statistical harmonisation of industrial production | | | |

| | Speeded up delivery | Shaped contents of reforms | Other (please specify) |
|---|---|---|---|
| data | | | |

12) What would have happened to the following conditionality if the MFA had not existed?

| | Would have been incorporated in IMF programme | Would have been incorporated in a WB programme | Would have been strengthened under SAA or CARDS | Would have autonomously become part of Government agenda at any rate | Would have been totally neglected so far | Don't know | Other please elaborate in the lines below |
|---|---|---|---|---|---|---|---|
| Application of the treasury system | | | | | | | |
| Customs and indirect tax reform | | | | | | | |
| Public procurement | | | | | | | |
| Bank privatisation | | | | | | | |
| Banking supervision | | | | | | | |
| Deposit insurance | | | | | | | |
| Insurance supervision | | | | | | | |
| Implementation of bankruptcy law | | | | | | | |
| Large scale privatisation | | | | | | | |
| Competition policy | | | | | | | |
| Phytosanitary standards | | | | | | | |
| Meat and animal product standards | | | | | | | |
| Statistical harmonisation of industrial production data | | | | | | | |

Other

________________________________________

________________________________________

________________________________________

13) If the MFA had not existed AND the Government had been forced to fill the financing gap with autonomous moves towards speeded-up structural reforms, what is your assessment of the likelihood it would have taken action in the following policy areas?

| | Very unlikely | Unlikely | Likely | Very Likely | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | | | | |
| Customs and indirect tax reform | | | | | |
| Public procurement | | | | | |
| Bank privatisation | | | | | |
| Banking supervision | | | | | |
| Deposit insurance | | | | | |
| Insurance supervision | | | | | |
| Implementation of bankruptcy law | | | | | |
| Large scale privatisation | | | | | |
| Competition policy | | | | | |
| Phytosanitary standards | | | | | |
| Meat and animal product standards | | | | | |
| Statistical harmonisation of industrial production data | | | | | |

OTHER GENERAL COMMENTS YOU WOULD LIKE TO ADD

# Annex 2: Overview of synergies with MFA conditionalities

| MFA conditionalities | Priority tasks listed in the Feasibility Study | World Bank Conditionalities & Projects | IMF SBA - Memorandum of Economic and Financial Policies |
|---|---|---|---|
| **Public Finance Reform and Administration** | | | |
| *Treasury system:* The state and entity authorities will continue to apply the Treasury system. In particular, in the Federation at least 7 Cantons will apply the Treasury system; in the Republika Srpska, 5 Municipalities will run pilot projects on the Treasury system, and at least 3 will apply the system. | *Budget legislation* – Adopt and start to implement a budget law covering multi-annual budget planning and forecasting and start to elaborate a consolidated government account.<br><br>*Budget practice* – Take steps to record all income accruing to public authorities at different levels of government, including grants and other forms of international assistance. | *PFSAC:*<br>*A3* Each entity has implemented a new arrangement, including an information sharing system, for administrative coordination with the other entity<br>*D9* The State and each entity have put into operation a Single Treasury Account and adopted a system to manage budget execution through its Treasury Ledger Account | *MoU 2002:* Work on the treasuries according to our work plans will continue. The first cantonal pilot project in Sarajevo will commence on April 1 2003, to be followed by further pilots in two other cantons shortly thereafter. We will remain committed to begin treasury operations in all cantons on January 1, 2004. In the RS, we will resume discussions with the municipalities with the objective to get an agreement with 3 municipalities by February 2003 on plans to introduce treasury pilot projects<br>*MoU 2004:* In the RS, we aim to implement treasuries in 5 pilot municipalities by early 2004) |
| *State Border Service*: The State authorities will ensure proper functioning of the State Border Service through appropriate funding | *Customs and taxation reform:* Proceed with implementation of the recommendations of the Indirect Tax Policy Commission. Ensure | *PFSAC:*<br>*A1* Each entity has completed harmonization of its sales tax system by reducing the difference in sales tax rates | *MoU 2002:* Any changes to the current indirect tax system should retain or strengthen the principle of harmonization |

| **MFA conditionalities** | **Priority tasks listed in the Feasibility Study** | **World Bank Conditionalities & Projects** | **IMF SBA - Memorandum of Economic and Financial Policies** |
|---|---|---|---|
| *Excises*: The Entities and the Brcko District will continue to implement the laws which have established the excise attribution mechanism, and thereby avoid double taxation on excises | parliamentary adoption of the Law on the Indirect Tax Authority, including the adoption of the related enabling legislation. Ensure implementation, including the appointment of a Director for the Indirect Tax Authority and the functioning of the new customs authority.<br>Demonstrate progress in preparing the introduction of VAT with a view to beginning on schedule. | *A2* Each entity has put into effect its amendments to its sales and excise tax legislation on inter-Entity allocation on excisable goods and excise taxes<br>*B4* Each entity has eliminated all tax and duty exemptions that are not provided for under its respective tax legislation or international treaties<br>*EMSAC:*<br>*3 (i)* The State has adopted a new law establishing the single Indirect Tax Authority (ITA)<br>*3 (ii)* The State Government has established the ITA Governing Board with mandate to (i) organize merger of Entity customs and indirect tax administrations (ii) formulate harmonized indirect tax policy and (iii) introduce VAT | *MoU 2002:* The Entities and Brcko District will implement laws establishing the excise attribution mechanism as previously agreed with the World Bank and thereby avoid the double taxation on excises |
| *Customs and tax administration*: The Council of Ministers will adopt the Interim Law Merging the Customs Administration and Establishing the Indirect Taxation Authority, as proposed by the ITPC and submit it to the State Parliament. Moreover, the Framework Law, including general VAT legislation, will be submitted for parliamentary consideration. | | | *MoU 2002:* We remain committed to the harmonization of indirect taxes. We are investigating how to strengthen customs administration further. We have begun discussions to replace the sales tax with a VAT.<br>*MoU 2004:* We have focused our efforts on passing the framework legislation for the ITA) |
| *Statistics*: (-) The three Statistical Agencies will continue to make progress on the harmonisation of statistics by completing the tasks as foreseen in the 'Plan of Activities 2002-2003' on the Harmonisation of Statistics. In particular, the indicator on industrial activity will be | *Reliable statistics:*<br>Implement the Law on Statistics, aiming at the creation of a functioning system of statistics with clear lines of responsibility and coordination mechanisms | *EMSAC:*<br>*3 (iii)* The State Government has approved and submitted to State Parliament a new framework Law on Statistics<br>*3 (iv)* The State Government appoints Director of State Statistical Agency and establishes Statistical Council | *MoU 2002:* We will implement the new statistics law, including by amending entity statistical laws and will set up the required infrastructure for the State agency to carry out its mandate.<br>*MoU 2004*: We have focused our efforts on appointing a Director and a Statistical Council for |

| MFA conditionalities | Priority tasks listed in the Feasibility Study | World Bank Conditionalities & Projects | IMF SBA - Memorandum of Economic and Financial Policies |
|---|---|---|---|
| harmonised at State level.<br>(-) Following the appointment of the Director of the Bosnia and Herzegovina Agency for Statistics, a Statistical Council will be established and a Chairperson will be nominated, with the view to start drafting the internal book of rules and regulations. | | | the State Agency for Statistics |
| *Public procurement:* The Bosnia and Herzegovina governments will submit to the State and Entity Parliaments draft legislation on Public Procurement. | *Develop the BiH single economic space*: Implement a consistent and effective public procurement regime throughout the country | *EMSAC:*<br>*4 (i)* The State Government has enacted the Public Procurement Law satisfactory to the Association<br>*4 (ii)* The State Public Procurement Agency and the Procurement Review Body are established and operational<br>4 (iii) The governments of the State and both Entities have promulgated implementing regulations consistent with the Public Procurement Law; | |
| **Financial Sector Reform** | | | |
| *Privatisation of banks:* All remaining state-owned banks will have been privatised according to the timetable prescribed by law. Those state-owned banks which have not been privatised by the final deadline will undergo bank resolution procedures, as | | *EBPAC:*<br>The entities (-) establish each Bank Privatisation Agencies with full staffing; (-) evaluate the solvency of the state-owned banks and either sell them to private investors or liquidate them | *MoU 2002:* We have almost completed bank privatisation. By end 2002, at most two active banks will remain publicly owned in each Entity. We will raise minimum capital requirement and prepare regulations to implement new banking laws and strengthen banking |

| MFA conditionalities | Priority tasks listed in the Feasibility Study | World Bank Conditionalities & Projects | IMF SBA - Memorandum of Economic and Financial Policies |
|---|---|---|---|
| prescribed by law. | | | supervisory agencies. Banks which do not meet the required standards will be liquidated by 2003 |
| *Banking supervision:* (-) Banking supervision will be strengthened by enforcing the current prudential regulations. (-) In order to strengthen the soundness of the banking system, banks will comply with the requirements of the State Deposit Insurance Agency. | *Develop the BiH single economic space*: Remove all duplicate licences, permits and similar authorisation requirements to allow service providers (including financial institutions) to operate throughout BiH without having to fulfil unnecessary administrative requirements. | *EBPAC:* (i) A single State Level Deposit Insurance Agency is established (ii) The entities (-) enact a Law on Deposit Insurance satisfactory to the Association, (-) refrain from funding new credit lines from budget resources | Banking regulation has strengthened and we have created the state Deposit Insurance Agency and opened a branch in both entities. Banking supervision will be further strengthened by enforcing the current prudential regulations |
| *Insurance:* The State Insurance Commission will have begun functioning, on the basis of the adopted State Framework Law. The Entity Parliaments will have adopted harmonised insurance legislation. | | | |
| **Private Sector Development and Business Environment** | | | |
| *Bankruptcy:* Entity governments will have adopted harmonised laws on Bankruptcy and Liquidation. With a view to accelerating the handling of bankruptcy cases, based on the harmonised bankruptcy legislation, the authorities will ensure proper functioning of the Commercial Departments established within Municipal and Basic. | | *BAC:* *A4* The Federation has adopted the Law on Bankruptcy and Liquidation satisfactory to the Association *B4* Republika Srpska has adopted the Law on Bankruptcy and Liquidation satisfactory to the Association | *MoU 2002:* A strong bankruptcy law was adopted in the RS and similar legislation is under discussion in the Federation. We will encourage the use of the bankruptcy laws *MoU 2004:* We have focused our efforts on passing draft amendments of our bankruptcy laws to limit the priority given to labour claims. We will accelerate efforts to complete the |

| MFA conditionalities | Priority tasks listed in the Feasibility Study | World Bank Conditionalities & Projects | IMF SBA - Memorandum of Economic and Financial Policies |
|---|---|---|---|
| | | | establishment of 16 commercial departments in the courts. |
| *Privatisation:* The Republika Srpska will offer for sale at least six additional companies from the list of 80 strategic enterprises. The Federation will offer for sale at least another eight additional companies from the list of 56 strategic enterprises. | | *BAC:*<br>The conditions initially focused on initiating the process of privatisation by establishing the legal and institutional framework. During project implementation, a target for 500 small-scale enterprises , 100 large companies and 1 holding company was defined for the FBiH. The RS was to execute the privatisation of 85 small scale enterprises, 3 large ones and 1 holding company.<br><br>*PTAC:*<br>*(i)* Tender sale of state owned enterprises Assist<br>*(ii)* Supporting the privatisation of state owned enterprises undergoing special privatisation programs<br>*(iii)* Supporting measures to enable privatisation of state-owned enterprises<br>*(iv)* Capital market development<br>*(v)* Institutional support and project implementation | *MoU 2002:* We will continue the privatisation of SMEs and accelerate large-scale privatisation with the support of the International Advisory Group for Privatisation. The privatisation of some 50 remaining Federation strategic enterprises will be accelerated, including tobacco, electricity and telecom companies. Tenders for privatisation of the RS petroleum refining companies will be issued and plans for new tender issues in 2003 will be advanced.<br>*MoU 2004:* We focus our efforts on accelerating privatisation towards goals of issuing tenders for at least 5 strategic enterprises by the end of 2004 |
| *Competition:* The State authorities will implement the Competition Law. In particular, they will establish the Competition Council and appoint its members, thereby | *Develop the BiH single economic space:*<br>Establish the Competition Council. Introduce provisions on the mutual recognition of products in the legal order of BiH | | |

| MFA conditionalities | Priority tasks listed in the Feasibility Study | World Bank Conditionalities & Projects | IMF SBA - Memorandum of Economic and Financial Policies |
|---|---|---|---|
| fostering the development of a single economic space. | (…). Create a single business registration system that is recognised throughout BiH. | | |
| *Veterinary office:* The State Veterinary Office will become fully operational by 1 October 2003 | *Consistent trade policy:* Establish at State-level certification and other procedures for the export of animal products and a phytosanitary office that are EC-compatible, with a view to promoting exports, but also enhancing standards and the single economic space. | | *MoU 2004:* We will focus our efforts on removing impediments to agricultural exports by strengthening the Veterinary Office and Institute for Standardization |
| *Phytosanitary office:* The State Parliament will approve national phytosanitary legislation by 15 October 2003 to improve the quality of plants and seeds for domestic and export markets. | | | |

# Annex 3: Delphi tables of international respondents

**Table 1** **Responses from internationals to the question 'How do you assess the importance of proposing the following structural reforms in the BiH policy agenda at that time?' (see Table 6.3 for all respondents)**

| Conditionality | Inappropriate Priority | Minor issue | Important issue | Key priority | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | | | 4 | |
| Customs and indirect tax reform | | | | 4 | |
| Public procurement | | | 3 | 1 | |
| Bank privatisation | | | 3 | 1 | |
| Banking supervision | | | 2 | 2 | |
| Deposit insurance | | 2 | 1 | | 1 |
| Implementation of bankruptcy law | | | | 4 | |
| Large scale privatisation | | | 2 | 2 | |
| Competition policy | 1 | | 3 | | |
| Phytosanitary standards | | 2 | 1 | | 1 |
| Meat and animal product standards | | 2 | 1 | | 1 |
| Statistical harmonisation of industrial production data | | | 3 | 1 | |

**Table 2** **Responses from internationals to the question 'If the MFA had not existed AND the Government had been forced to fill the financing gap with autonomous move towards speeded structural reforms what is your assessment of the likelihood it would have taken action in the following policy areas?' (see table 6.4 for all respondents)**

| Conditionality | Very unlikely | Unlikely | Likely | Very Likely | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | 2 | 1 | 1 | |
| Customs and indirect tax reform | 2 | 1 | | 1 | |
| Public procurement | 1 | 2 | 1 | | |
| Bank privatisation | | 1 | 1 | 1 | 1 |
| Banking supervision | | 2 | 2 | | |
| *Deposit insurance* | | *2* | *1* | | *1* |
| *Implementation of bankruptcy law* | *2* | *2* | | | |
| Large scale privatisation | 1 | 1 | | | 2 |
| *Competition policy* | *1* | *2* | | | *1* |
| *Phytosanitary standards* | | *1* | | | *3* |
| *Meat and animal product standards* | | *2* | | | *2* |

| Conditionality | Very unlikely | Unlikely | Likely | Very Likely | Don't know |
|---|---|---|---|---|---|
| *Statistical harmonisation of industrial production data* | *1* | *2* | | | *1* |

**Table 3** **Responses from internationals to the question 'How do you assess progress achieved in the following policy areas in comparison with the situation in mid-2002?' (see Table 6.6 for all respondents)**

| Conditionality | Worsened | The same | A bit better | Much better | Don't know |
|---|---|---|---|---|---|
| Application of the treasury system | | | 2 | 11 | 1 |
| Customs and indirect tax reform | | 1 | 1 | 11 | 1 |
| Public procurement | | 2 | 5 | 6 | 1 |
| Bank privatisation | | 1 | 3 | 9 | 1 |
| Banking supervision | | 1 | 7 | 6 | - |
| Deposit insurance | | 1 | 5 | 6 | 2 |
| Implementation of bankruptcy law | 1 | 9 | 3 | - | 1 |
| Large scale privatisation | 2 | 4 | 5 | 0 | 3 |
| Competition policy | | 7 | 5 | - | 2 |
| Phytosanitary standards | | 4 | 6 | - | 4 |
| Meat and animal product standards | | 4 | 5 | - | 5 |
| Statistical harmonisation of industrial production data | | 6 | 6 | - | 2 |

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# Annex 5: Key people involved in the MFA operation

The table below lists the key persons that have been involved in the MFA intervention in Bosnia and Herzegovina

| Institution | Name | MFA Involvement |
|---|---|---|
| **European institutions** | | |
| | | |
| **DG ECFIN** | Mrs. B. Kauffman | Former Head of Unit (till 2004) |
| | Mr. C. Pavret de la Rochefordiere | Deputy Head of Unit |
| | Mr. P. Grasmann | Head of Unit (from May 2004) |
| | Mrs. K. Bergkvist | Desk officer (from May 2004) |
| | Mrs. F. di Mauro | Former desk officer (till May 2004), Present in EC Delegation in Lusaka |
| | Mr. Vasilis Lelakis | Supervisory role, Present Director of EC at EBRD |
| | | |
| **DG ELARGE** | Mr. Reinhard Priebe | Director Western Balkans |
| | Mr. Clive Rumbold | Desk officer |
| | Mrs. Michela Matuella | Desk officer (from 2005) |
| | Mr. Josee. L. Sanches | Political desk officer (since 2005) |
| | | |
| **EU Delegation** | Mr. Michael B. Humphreys | Head of Delegation |
| | Mr. Renzo Daviddi | Head of Political and Economic Section |
| | | |
| **BiH Institutions** | | |
| **State** | Anto Domazet | Minister of Treasury |
| | Ljerka Marić | Minister of Treasury (from 2003) |
| | Mr. Osman Topcagic | Director for European Integration |
| | Ms. Bejta Delic | Technical implementation of MFA |
| | Ms. Radmila Pustahija | Technical implementation of MFA |
| | | |
| **Federation BiH** | Mr. Vilendacic | Minister of Finance |
| | Dragan Vrankic | Minister of Finance (from 2003) |
| | Mr Enver Trepic | Assistant Minister of Finance (banking, international finance, insurance) |
| | | |
| **Republika Srpska** | Mr. Hajrudin Hadimesanovic | Assistant Minister of Finance (fiscal policy) |
| | Mr Simeun Vilendecic | Minister of Finance |

| Institution | Name | MFA Involvement |
|---|---|---|
| | Mr. Branko Krsmanovic | Minister of Finance (from 2003) |
| | Mrs. Mira Strazivuk | Assistant Minister of Finance (financial sector) |
| | Ms Gordana Prastalo | Assistant Minister of Finance (cooperation with IFI's) |
| | | |
| **Central Bank** | Peter Nicholl | Governor of the Central Bank of BiH (until dec 2005) |
| | Mr Kemal Kozaric | Governor of the Central Bank (from 2006) |
| | Mr. Ljubisa Vladusic | Vice Governor Central Bank |
| | Mrs. Feiha Imamovic | Vice Governor Central Bank / Head of Banking division |
| | | |
| | | |
| **International Institutions** | | |
| **IMF** | Mrs. Valeria Fichera | Resident Representative (2002-2004) |
| | Mr. Graham Slack | Resident Representative (2004-2006) |
| | Mr. Peter Doyle | Mission Chief |
| | Mrs. Berina Selimovic-Mehmedbasic | Economic Advisor |
| | Messrs. Demekas, Chelsky, Kanda | Staff of European Department |
| | | |
| **World Bank** | Mr. Joseph Ingram | Resident Representative |
| | Mr. Dirk Reinermann | Resident Representative |
| | Mr. Fransz Kaps | Director Joint WB-EU office for South Eastern Europe |
| | | |
| **Office of High Representative** | Mr. Donald S. Hays | Principal Deputy High Representative |
| | Mr. Larry Butler | Principal Deputy High Representative |
| | | |

# Annex 6: People interviewed

The following officials of the European Commission, International Financial Institutions, BiH authorities and others have been interviewed:

**DG ECFIN**
Mrs. B. Kauffman, Head of Unit (until May 2004)
Mr. P. Grasmann, Head of Unit (from May 2004)
Mr. C. Pavret de la Rochefordiere, Deputy Head of Unit
Mrs. K. Bergkvist, desk officer (from May 2004)

**DG ELARGE**
Mr. Josee. L. Sanches, political desk officer (since 2005)
Mr. Clive Rumbold, desk officer

**EC DELEGATION in BiH**
Mr. Emil Okanović, Economic Advisor
Ms. Lejla Ramić, Sr. Secretary to Mr. Woebking

**IMF**
Mr. Peter Doyle, Former Mission Chief
Mrs. Valeria Fichera, Former Resident Representative
Mr. Graham Slack, Resident Representative
Ms. Irena Jankulov, Economic Advisor
Mr. Alan Jensen, Former Head of CAFAO in Bosnia and Herzegovina, presently staff member of IMF Fiscal Affairs Department

**WORLD BANK**
Mr. Bernard Funck, sector and area manager
Mr. Robert Jauncey, country economist
Mr. Ivailo Izvorksi, senior country economist
Mr. Dirk Reinermann, Head World Bank office in Sarajevo

**OFFICE OF THE HIGH REPRESENTATIVE**
Mr. Herbert Priebitzer, Head of Economic Transition Unit
Mr. Miroslav Tomić, Economic Advisor
Mrs. Marija Buntić, Economic Advisor
Mr. Alem Cokljat, Economic Advisor

**CENTRAL BANK OF BiH**
Mrs. Feriha Imamović, Vice-Governor, Head of Banking Division

Mr. Peter Nicholl, Former Governor, at present Advisor to Governor of CBBiH and Chairman of Governing Board of Indirect Tax Authority

**FEDERATION OF BiH**
**FBiH Ministry of Finance**
Mr. Dragan Vrankić, Minister of Finance
Mr. Enver Trepić, Assistant Minister for Banking and Insurance and International Finance
Mr. Hajrudin Hadžimehanović, Assistant Minister for Fiscal Policy
Mrs. Vera Letica, Head of Minister's Cabinet

**FBiH Insurance Supervisory Agency**
Mr. Branislav Bilic, Director
Mrs. Anita Putica, Head of Actuaries and Technical Provisions, Supervision Department

**REPUBLIKA SRPSKA**
**RS Ministry of Finance**
Mrs. Dragana Aleksić, Advisor, future Assistant Minister for Debt
Mrs. Snježana Rudić, Assistant Minister for Financial Sector
Ms. Gordana Praštalo, Assistant Minister for Cooperation with IFIs
Mrs. Radmila Mihic, Head of Minister's Cabinet

**RS Privatisation Directorate**
Mr. Vladimir Mačkić, Director

**RS Administration for Inspection Activities**
Mr. Slavan Subotic, Director

**BOSNIA AND HERZEGOVINA STATE GOVERNMENT**
**BiH Ministry of Finance and Treasury**
Mrs. Ljerka Marić, (former) Minister of Finance and Treasury of BiH
Mrs. Radmila Pustahija, Sector for IFI Cooperation

**BiH Indirect Tax Authority (located in Banja Luka)**
Mr. Kemal Čaušević, Director

**BiH Directorate for European Integration (DEI)**
Mr. Kenan Tahmiščić, Assistant Director for Aid Coordination

**Federal Privatisation Agency**
Mr. Hamdija Kulović, Assistant Director for Tender Sales

**State Veterinary Office**
Dr. Nihad Fejzic, Deputy Director

**CAFAO**
Mr. Andrew Bloomfield, Tax Developments Senior Expert

**PRIVATE SECTOR**
**Sarajevo Stock Exchange**
Mr. Zlatan Dedić, Director, Former FBiH Privatisation Agency Staff

**DONOR COMMUNITY**
Mr. Garth Armstrong, senior economist at DFID
Mr. Donald Spatz, Chief of Party, USAID Solidarity Center
Mr. Suad Muhibić, Local Economist – Privatisation specialist, USAID Solidarity Center

**RESOURCE PERSON**
Mr. Josef Poeschel, Team Leader CARDS project EU Support to the Economic Policy Planning Unit, Directorate for Economic Planning